THE BOOK WAS DRENCHED

PRESENT-DAY BANKING IN INDIA

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BY

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TO

The Hon'ble SIR ASUTOSH MOOKERJEE,
Kt., C.S.I.,

This book is respectfully dedicated by the Author

as a token of his affection, admiration,

respect and gratitude.

PREFACE TO THE FOURTH EDITION

In the Third Edition, which was my supplementary thesis for my Ph.D. Degree examination, I mainly devoted my attention to the filling up of the gaps in our banking structure. In this revised edition I have taken up the essential problem of securing orderly banking progress. The evolution of an active national banking policy is no less essential than the one of curbing the predominant control of our banking resources and progress by foreign banks.

Taking the initiative from the banking progress of other countries certain lines on which a national policy can be chalked out have been indicated. It is a matter of gratification to me that in all matters of recent banking activity my recommendations have borne fruit. Few instances can be cited. Like myself the C. B. Enquiry Committee recommend the starting of City Mortgage Banks in addition to Urban Co-operative Banks. The formation of a shareholder's type of Central Bank under proper safeguards, the starting of co-operative type of Land Mortgage Banks in the province of Bengal and the starting of few Investment Trusts, on lines indicated in this book are a source of pride and profound satisfaction that my mental exertion has not been undertaken in vain. The recent Sir Pochkhanawalla Committee has recommended the starting of an Industrial Bank on lines similar to those outlined by me. A new Overseas Bank has been started by the Central Bank of India.

But the banking problem remains and is still with us to-day. Heavy interest rates, inadequate supply of loanable capital, the universal dominance of the rural money-lenders by whatever name they are styled, lack of free mobility of money capital, the paucity of existing banking facilities, the adaptation of loan companies and *nidhis* into well-managed joint-stock banks, the absence of a definite state policy of encouraging indigenous banking institutions, the scattered, meagre and misleading banking statistics, the increasing domination of foreign banks in the banking field, the policy of ' open door ' leading to the invasion of Indian banking field by British as well as non British Exchange Banks, the absence of co-operation between the different banking units and the reluctance of the Foreign Exchange Banks to increase the Bill habit and develop the Rupee Bills have had direct influence in dwarfing our banking progress.

A national banking policy consists in considering banking as a key enterprise. The endeavour of the State should be to guide the activity of the enterprise in a manner conducive to the permanent reconstruction or the building of a lasting and sound banking foundation for the economic structure of our country. The banking regulatory authority should benefit the children of the soil and retain the profits and experience within the country itself.

Now that the different gaps in the banking field are being filled up by the starting of a Reserve Bank, the starting of Land Mortgage Banks, Investment Trusts, and the modernising of the indigenous banking activity, banking progress ought to be stimulated by beneficial and intelligent changes in the banking regulations of the country. The most important necessity is the starting of few Indian Overseas Banking concerns to assail the monopoly of foreign trade financing and reap all incidental gains accruing from the policy of financing the bulk of our foreign trade with the help of domestic resources. An active economic policy co-ordinating their efforts in the field of agriculture, trade and industry would bring us nearer the goal. Measures of banking reform in other directions have been indicated in the different chapters.

An efficient mortgage banking system based upon the long-term mortgage principle amortisable gradually over a series of years would aid our agriculture, building societies, life insurance companies, and commercial banks at the same time.

India's banking destiny lies in her own hands. It lies in an intelligent re-organisation of the banking enterprise on lines indicated in the different pages of my book. Although the Central Banking Enquiry Committee made an exhaustive enquiry into the banking problem of our country, still its main recommendations which amplify and endorse my suggestions in most cases have not been carried into effect as yet. Our nationalist leaders must be actuated with an aggressive desire to contribute their time and efforts to general banking reform. Fifty ponderous tomes covering roughly 20,000 printed pages have been produced by the recent Banking Committees but it has not occurred to the nation that the needed proper action could be delayed no longer.

CALCUTTA:
28th September, 1936

B. RAMACHANDRA RAU

PREFACE TO THE THIRD EDITION

Bearing in mind the changes that have taken place during the eventful years of 1925-27, I have rewritten the Second Edition pointing out the effects of such changes on the general public, the Imperial Bank of India, the immigrant banks, the indigenous joint-stock banks and the indigenous bankers of our country. The descriptive material in the different chapters has been brought up to date. The long chapter on banking reform has been split and rearranged into different chapters. The most important additions are the chapters on the Central Bank of Issue, Organised Banking in the Days of John Company, the Capital Market and the Investment Market, the Loan Companies of Bengal and Recent Monetary Reform.

It is a matter of sincere gratification to note that most of my views, valuable hints and fruitful suggestions offered in the previous edition have been accepted by the recent Royal Commissions on Currency and Agriculture. The 1926 Conference of Registrars of Co-operative Societies have practically endorsed the suggestion for a separate credit organisation for granting long-term credit facilities to agriculture. The idea of starting a separate State Bank for financing agriculture and industries which immature Indian authors generally mechanically repeat has been happily knocked on the head. The recommendations of the Hilton-Young Commission, the External Committee and the Royal Commission on Agriculture which aim at setting right the currency and the financial system of the country and the re-organisation of the rural credit system of the country have like myself clearly pointed out the necessity of breaking the gauge in the existing banking organisation. Most of my suggestions are repeated afresh by these authoritative bodies. One of my intelligent reviewers, who does not, however, give me any constructive suggestions, writes that " in his long chapter on banking reform he anticipates a good few of the suggestions made by Sir Basil P. Blackett in his very informing and suggestive address to the Delhi University, *e.g.*, the standardisation of the forms of Negotiable Instruments, the use of the vernacular in the printing of the cheque, the need for special banking legislation apart from the general Company Law, etc."

The establishment of the One Reserve system, the abolition of the stamp duty on bills of exchange, the creation of a Central Bank of Issue, the fusing of the indigenous banker as an integral feature of the organised banking system, the undertaking of acceptance business by the Banks and the creation of a discount market have been pointed out by me, and these are some of the very suggestions which are offered by the Central Banking Enquiry Committee and the present-day publicists for the improvement of the banking system. With reference to the exchange, the investment and the discount market and the re-organisation of the indigenous bankers' business I have added further suggestions in the different chapters of this book. I have suggested measures to remedy the defects of the existing law in regard to the responsibility of directors. Means to improve the investment habit on the part of the people have been recommended. The necessity of compelling the Exchange Banks to afford prospects of a career in banking and thus creating an Indian banking personnel has been pointed out. Some of the present defects of co-operative finance, the unreliability of some of the *shroffs*, the amount of possible competition between the Imperial Bank and other Joint-Stock Banks, and the dangers underlying the recent merger between the Big Five and the Exchange Banks in our money market have been outlined. Attention has been drawn to the working of the agricultural banks of other countries and the lessons that have to be learnt from their example are pointed out. I have indicated the steps by means of which the Central Bank of Issue can gradually secure control over the internal credit situation and I have devoted special attention to free the study of banking organisation from all non-essentials, so that the reader can comprehend it clearly. Barring the collection of data and statistics which a Government Committee alone can compile I have endeavoured my level best to make a scientific survey of the existing banking organisation and present a programme on clear cut lines for immediate attention on the part of the bankers, the general public and the Government. Safe and sturdy banking development under the regulation and control of a Central Bank affords the only reliable means for the proper and healthy economic progress of our country.

I have suggested practical scientific remedies for enabling the people to shake off their hoarding habit. I have attempted to probe

deep into this "old problem" obscured by an overgrowth of peculiar misconceptions, fads and exaggerations of specialists and scientific inexactitudes resulting from purposeless or ineffective inquiries. There is no greater prevailing misconception than that India has hoarded in utter disregard of economic considerations and that the Indian still persists in the hoarding habit in the same manner and to the same degree. The Indian is not a mere slave to the primeval instinct of acquisitiveness. His hoarding is the direct result of prudence, economic needs, and unforseen contingencies. Doubtless he may be mistaken but he is not perverse. I have proved by a process of elimination that there is no considerable portion of the population which continues to keep its savings in the form of idle cash. As there is still left much of the evil to tackle, I have made a list of practical suggestions which would go a long way in ensuring a truly economic use of the national savings. Some of my practical suggestions would go to the root of the matter and act as a sharp spur to economic improvement. I will only add that the usefulness of the Central Bank of Issue will depend on its ability to get into close and living touch with and to alter for the better the economic life of the larger masses of India's rural population. There is no discussion of this important problem before the Royal Commission on Agriculture and the Banking Committees should not fail to tackle this problem.

Another salient lesson which I propose to emphasise is the necessity to solve our problems in banking, currency and industry by measures which go hand in hand. Fragmentary reform of currency or banking is futile. Simple, intelligible and reliable measures which pay proper heed to the habits of the people are essential.

In the chapter on Organised Banking in the Days of John Company I have succeeded in pointing out the work of a few banking institutions whose names alone are known to the existing contributors on the subject. I have literally exhumed from the graves in which they have been buried the unrecorded material of some banks of this period and they find a place for the first time in a book on Indian banking. As students of archaeology, by finding a bone here a piece of tesselated pavement there, in another place some pottery or rust-eaten apparel, have caught glimpses of our civilisation; so also I have tried to collect heterogeneous facts from published Government records, old books,

pamphlets and newspapers of this period and present a comprehensive list of some of the banks working during this period.

In my forthcoming monograph on Organised Banking in the Days of John Company (now published by Lal Chand and Sons, 76, Lower Circular Road, Calcutta—Rs. 4) further details and a more comprehensive account of these banks, whose history has been unearthed for the first time, would be presented. The present banking system of India is a very different thing from what it was. It has been my aim to show in this monograph the economic forces at work in this period. Bankers, like other human beings, are creatures of their environment. As heirs of all the past ages it behoves us to know the working of these institutions that did their duty in the dim past, for the past always lives on and works in the present. Lessons will be drawn from the lives of dead (Bankers) and a study of the right inference drawn would go a long way in eradicating unsound banking management in this country.

This book is only a companion volume of my book " Elementary Banking for Indian Beginners " where the theory underlying the successful working of a Commercial Bank and every other specialising banking concern is taught in a " clear and concise manner " as the *American Economic Review* puts it. The Bibliography at the end of this book would be of use to all who are interested in pursuing their studies further in this direction. I hope readers would judge the work by the accuracy of its recommendations and not by the atmosphere in which they are stated.

It has been my endeavour throughout the book to avoid outlining cut-and-dried schemes either in the matter of framing banking legislation or in the matter of formulating proposals for starting industrial, agricultural, or any other type of specialised banking institutions. Throughout the book the object has been to indicate the theoretical necessity and outline a basis for the new changes and give sufficient indication of the practice of foreign countries in these lines in support of the line of reasoning adopted by me. I am much obliged to the Syndicate of the Calcutta University for permitting the Punjab Co-operative Union, Lahore, to undertake a translation of the Second Edition of this book into Urdu.

I desire to express my thanks to the Editors of the different journals, *e.g.*, *Bengal—Past and Present*, the *Calcutta Review*, the *Welfare*,

the *Mysore Economic Journal*, the *Indian Finance*, the *Cosmopolitan*, the *Servant of India*, the *Modern Review* and the *Capital* for permitting me to incorporate some of my recent contributions on banking in this new edition. My thanks are due to the Hon'ble Mr. Ramaprasad Mookerjee and Raja Reesheecase Law through whose courtesy I could gain access to the Library of the Calcutta branch of the Imperial Bank of India. I desire to place on record my appreciation of the assistance given me by Mr. J. A. Chapman of the Imperial Library, Calcutta, without whose help I would not have gained access to important books dealing with the chapter on Organised Banking. My thanks are also due to the Consulate Generals of Japan and Germany for enabling me to secure useful information about the Japanese and German Banks. Only a portion of much of the material that I have gathered in this way has been made use of in this book. I have added materially much information to the account of the old Presidency Banks which has not been given either by Cooke or Brunyate. I have succeeded in pointing out the individual who was responsible for adding unconsciously the words " payable in India " after the phrase " bills of exchange " thus precluding the Bank of Bengal from transacting foreign exchange business.

SENATE HOUSE,
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Feby., 1928

B. RAMACHANDRA RAU

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PRESENT-DAY BANKING IN INDIA

CHAPTER I

THE INDIAN MONEY MARKET

The importance of credit—The constituents of the Money Market—The functions of the Money Market—Some salient features of the Indian Money Market—The Treasury Balances and the Money Market—India's vast sub-continental size—General characteristics of the busy season—General characteristics of the slack season—Some notable features of Indian banking practice—Lack of autonomous Money Market—Stages in the evolutionary development of the Money Market—The stabilisation of the Money Market—The intelligent guidance of the Central Bank.

The importance of credit.

Apparently Lord Byron was wrong when he wrote that "Cash rules the camp, the court and the grove." He ought it seems, to have added that " not cash alone but credit also rules the camp, the court and the grove." We are not in need of any commentary upon statements of this kind. Even the man in the street can easily realise that credit is the life-blood of commerce. To promote agricultural and industrial advance a productive use of credit is essential. An elastic credit system can be created only by a well-developed money market. A fully co-ordinated system of credit possessing different types of complementary institutions can never exist without its indispensable concomitant, a well-developed and reasonably planned money market. The development of the one leads to the perfection of the other and *vice versa.* The money market is the groundwork of the country's national finance whose main flexibility depends on a fine division of labour and capacity for adjustment of changing financial conditions of society. The liquidity of the money market is such that cash can be secured within a few hours' notice. As one recent writer says, " what a bank balance is to the individual the money market is to the country's credit system. Both represent ready cash available for immediate needs." The money market is the place to which the floating capital of the community gravitates to find short-period employment till the time when it is needed for a permanent investment. It is on account of this feature that the

bill market, the exchange market and the investment market have very intimate and close connection with the money market and occupy a position of real importance in the money markets of the country.

The constituents of the Money Market.

The money market is the centre where the borrowers of money and the lenders of money meet together. The Indian money market is generally divided into (1) the European money market consisting of (*a*) the Reserve Bank of India, (*b*) the Imperial Bank of India, (*c*) the European Exchange Banks; (2) the Indian or native market consisting of (*a*) the Indian Joint-Stock Banks, (*b*) Shroffs, the indigenous bankers, the co-operative banks and the money-lenders who do a good deal of business in the giving of monentary credits. It is these that furnish the needed credit in our money market. The total amount of banking funds, *i.e.*, the avilable supply of funds, is adjusted to the demand for funds throughout the country.

The borrowers of money are (*a*) the Government of India who annually float rupee loans for capital expenditure on railway and canal construction, and pursue the policy of the sale of Treasury Bills in the money market for ordinary revenue account, (*b*) the agriculturists, (*c*) the entrepreneurs engaged in industries, (*d*) the Indian people who need money for performing social functions, say, marriages, *sraddhas* and other functions that have to be performed by people enslaved by debt, superstition and brahmanic ritual. Any sketch of the present-day banking system would not be complete without the inclusion of

[1] It is usual to speak of the whole country as one market and also refer to individual money markets of different centres. Just as the London Money Market and the New York Money Market are the national markets for their countries where the surplus funds find employment, so also in this country Bombay and Calcutta are the leading national money markets. One distinguishing feature is that the banking and financial operations in the Calcutta Money Market like its trade and business are solely under European management. Secondly, money rates in the Bombay Market are always firmer than in Calcutta. Specially in the busy season there is general divergence between the two rates. The real explanation for this difference lies in the fact that jute financing is done when no other crop makes demand for finance and the jute interests possess large financial resources of their own; whereas cotton is financed in the midst of the busy season when pressure for rice-financing also is keenly felt. Cotton is financed largely by bank credit. In January to April there is an outflow of funds from Calcutta to finance Bombay Cotton and Burma Rice.

at least the co-operative credit societies, the Post-office Savings Banks, the Insurance companies and the Stock Exchanges which form important elements in a highly organised money market. Insurance companies are increasing in number. Besides investing in debentures and shares of industrial companies they lend to the loan offices and muffasil banks. They may soon become an integral part of the money market.

The functions of the Money Market.

The function of the money market is to furnish the needed credit amenities for the varied sections of the community. It transports short-term capital to the hands of those who can utilise it for productive purposes so that national dividend may be augmented.

The other important function which the money market in Western countries performs is the supplying of efficient currency. By a wise and proper regulation of the same it gives relative stability to the purchasing power of the money unit. It is the latter function that has not been understood properly. Light and more light is needed by the Government and the people at large to realise that elasticity of bank currency can be produced by business and that the diminution of the same causes its absorption. Seasonal as well as local flexibility can be easily imparted to the currency system when bank notes and bills of exchange expand and contract with the needs of trade. So long as people hold obscure notions as regards this concept of elastic currency no real improvement of the banking system can take place.

Some of its salient features.

A close survey of the Indian Money Market discloses the following characteristic features. There is not plenty of loanable money in the market to satisfy all these demands.[2]

[2] This fact can be understood if it is borne in mind that out of 2,500 towns only 400 towns have one bank office or a branch of a bank. There is gross inequality of money rates at different centres at one and the same time. In spite of what the foreign banking experts say there has been an insufficient growth of banking deposits during the past two decades. Frequent changes in money rates are still a curse which affects the poverty-stricken people. There is a lack of many specialising useful agencies which would otherwise have enriched the money market.

Secondly, the credit system has not been thoroughly studied and specialised in all its various forms and manifestations by perfectly organised institutions as in the case of the foreign countries, notably Germany and Japan. Credit is generally divided into long-term credit and short-term credit. Mortgage or long-term credit is now undertaken by wealthy individuals and usurious money-lenders much to the chagrin and disadvantage of the borrowers who are exploited according to the urgency of their needs. Land Mortgage banks do not exist in all the provinces. Personal or short-term credit is granted on the strength of the general standing of the borrower or of the surety and it is generally available for short periods only. In the bigger cities this business is mainly in the hands of joint-stock banks. In the larger villages co-operative credit societies are trying to meet the needs of the cultivators but to a certain extent the predominance of the usurious money-lender in up-country centres is the third factor of our money market.[3] The recently passed money-lenders' acts in some of the provinces have not succeeded in undermining their importance as yet. Another feature of our money market is that very few systematic attempts are pursued to develop the money power of the country by the existing banking institutions. Serious attempts have not been made in the past to induce the people to forsake their hoarding habit and turn their locked-up funds into fertile channels of industry and enrich their productive fields. The value of the small account has not been realised by the Indian Banks.[4] Bank money is command over capital as Dr. Marshall would say. If industrial financing is to be really improved, real capital, bank money and currency ought to expand in proper proportion. Prof. Hayek clearly demonstrates that an elastic currency operating through individualistic processes increases the productive machinery of the country.[5]

[3] The agriculturist money-lender in particular is becoming a terrible menace to our agricultural progress.

[4] In England any individual can open a banking account with five pounds only. The Indian banks stipulate for a minimum balance of Rs. 200 for opening a banking account. They do not pay heed to the relative poverty of the Indian people. Like the American banks they should be interested in the small savings account and advertise for it exclusively.

[5] See F. A. Hayek, " Prices and Production," Lec. I.

The lack of a centralised banking institution acting as a " guide, friend and philosopher " to all the smaller institutions and the consequent lack of concentration of reserves have been hitherto some of the prominent features of the Indian Money Market. The recently created Reserve Bank has not improved the situation as yet. Scattered reserves independently controlled by the indigenous bankers still exist.

The existing credit system is totally lacking in elasticity. Any extra demand for seasonal currency is not met by the expansion of banking credit. The Indian joint-stock banks have no power of issuing bank-notes. Their capacity to create credit in other forms is limited by their cash holdings which they maintain against their demand obligations. A bank's power to create credit depends solely on its cash reserve. With the small cash balances at the disposal of our banks they cannot aspire to have any expansion to satisfy the increasing want of credit in this country. The cheque system of issuing credit has not developed to a great extent to amend the inelasticity of the *currency media* in our country. So long as a central bank does not exist there can be no easing of the money market to any desirable extent during the busy season. One year's operation of the Reserve Bank could convince the people that a lower bank rate, *viz.*, 3½% could be made to prevail in the country. Even a three per cent. bank rate could be declared on account of " easy money conditions and the weight of money awaiting investment."

Another peculiarity of the Indian monetary situation is the lack of close contact or sufficient nexus between the European sections of the organised money market and the native *bazaar* section of the same. As the European bankers do not compete with the shroffs in the discounting of hundis of the small trader, the bazaar rate for the shroffs is independent. While the rates for bills of large traders and shroffs follow very closely the Imperial bank hundi rate it is the small traders who have to pay high discount rates as they do not inspire the same amount of confidence as regards their stability which the larger traders succeed in doing. Confidence and local custom generally settle the rates in the bazaar market for the small trader's bills.

It is generally 2 or 3 per cent. higher than the bank rate. Normally the shroffs are outside the influence of the organised banking system of the country. An idea of the native or bazaar rate prevailing

in Calcutta and Bombay can be gained by studying the annual reports of the Controller of Currency.[6] It need not be stated that the muffasil bazaar rates would be higher than the bazaar rates in the better organised money markets of Calcutta and Bombay. Even in the organised money market of Bombay, each bazaar has its own individual rate. These rates are not adequately controlled at all times by the bank rate. For example the call money rate in Bombay is often at the same height as the bank rate during the busy season months, *i.e.*, December to March. Sometimes call money cannot be obtained at any rate. Again when money was tight the call money rate used to rise to 5½ % or roughly 1 per cent. lower than the Imperial Bank rate. Call money is usually lent without taking any security from the borrowers but in the past there were never many failures to repay the loans promptly.[7] Another anomaly in this connection is that the *Inter-bank call money rate* might be low owing to easy money conditions in the market while the Reserve Bank rate might be ruling very high owing to its reduced cash balances. In the past such was the case very often with the bank rate of the Imperial Bank.[8] This is one instance which shows that the Imperial Bank's bank rate had generally no control over the other rates in the market. There used to be a divorce between the Imperial Bank's bank rate and the money rates in banking circles. Although the Government of India could at such times increase their balance by issuing currency against *ad hoc* securities it was not done as a result of its fighting shy of inflation.[9] Even though it was only the reverse process of previous deflation no such attempt was made. As the Government of India is no longer the currency authority such relief cannot be thought of in modern times of a Central Bank regime.

One unwholesome condition of the money market used to be the lack of tranquillity in the money rates. So late as in 1924-25 busy

6 See Appendix I, where the different money rates are arranged in a table and lessons are drawn from a study of conditions ranging over a course of three years.

7 See the Question of Sir P. Thakurdas—Hilton-Young Commission.

8 In the third week of November, 1928, the bank rate was raised to 6% while the money rate actually cheapened from 2 % to 1½% for short-term credits.

9 It is indeed a bad practice to issue notes against " ad hoc " securities or " createds " and if it is true that the Secretary of State has prohibited this advice it should be regarded as a welcome sign on the part of currency authority to pursue sound methods of finance.

season the bank rate rose to 9 % and it fell to 4 % after a few months. In a few months it again advanced to seven per cent. The spread between the two rates was often as high as 3 %. There were not sufficiently compensating influences against these large movements of money rates. Though the visible trade balance might be actually in favour of India on account of lively export activity, yet as a result of the rigid inelastic credit system high bank rates prevailed. Since these lines were written the Imperial Bank's bank rate has fallen to a low figure but it was still far higher than the bank rates of London or New York.[10] The following table gives the much needed information:—

Year.	Calcutta.	New York.	London.
1927	7	3½	4½
1928	7	5	4½
1929	7	4½	5
1930	6	2	3
1931	7	2	3

So arose the famous and puzzling economic paradox of high exchange and high discount rate going together.[11] It is left to the Reserve Bank to rectify this situation. All throughout its first year of existence it has maintained steadily the bank rate at 3½ % and lowered it to 3 % at the beginning of the busy season. The Government of India acted as the currency authority which was entirely responsible for the expansion and contraction of currency and "its management" as some critics had put it was "neither knave-proof nor fool-proof." The following table shows the amount of expansion and contraction of currency.

[10] The currency authority states that on account of good harvests prices of agricultural products fall resulting in redundance of floating money, disequilibrium of prices and an unduly strained foreign exchange position. Credit control and rationing of credit would have to take place at such times. The currency authority would have to control and raise money rates whatever might be its effect on industry and trade.

[11] Dr. Marshall was asked to explain this paradox of Indian banking before the Fowler Committee on Indian Currency, 1899—see his answer 11808.

Absorption of Currency since 1914.

(In Lakhs of Rs.)

	Rupees.	Notes.	Total.
Average for 5 years 1914-15 to 1918-19	2,208	1,672	3,880
1919-20	2,009	2,020	4,029
1920-21	2,568	590	3,158
1921-22	1,046	935	111
1922-23	956	387	569
1923-24	762	796	1,558
1924-25	365	251	114
1925-26	817	116	701
1926-27	1,976	340	2,316
1927-28	375	1,022	647
1928-29	303	357	54
1929-30	2,171	1,880	4,051
1930-31	2,158	1,137	3,295
1931-32	393	1,724	2,117
1932-33	756	1,483	2,239
1933-34	3	1,354	1,324
1934-35	321	32	353
Total for 16 years 1919-20 to 1934-35 ...	9,948	2,998	6,950
Average for 16 years 1919-20 to 1934-35 ...	622	187	435

In the past the Government's currency reserve did not substantially aid the operating power of the banks. The currency reserves were not available for the reconstruction of credit either in the long-term market or short-term market to the fullest possible extent. Its policy as regards the floating of loans or stabilisation of exchange was generally responsible for changes in the bank rate which ought to have fluctuated solely according to the state of funds and their demand in the money market. The *currency* authority being different from the *credit* or banking authority there was no proper co-ordination between the two and the lack of power on the part of the credit authority to control the money market made it unorganised. Of late the currency authority has been undoubtedly doing something to provide emergency

currency.[12] And the policy of purchasing sterling in India in order to remit to the Home Treasury undoubtedly constituted something towards easing the money market. The re-introduction of the Treasury Bills by the Government was also for attaining the same object. So long as the Government would continue to function as the currency authority some means to inflate or deflate currency to suit the business requirements are essential and free mobility of money can never be secured in the Indian money market which is subject to seasonal variations without such suitable devices. Happily for the country these circumstances have at last changed. The Reserve Bank controlling both the credit and currency systems can improve the situation to a marked extent.

Even if the Government were not to be the controlling currency authority it would still hold the whip hand in the money market though it might or might not use its controlling power. The impingement of the Government financial operations on the money market has not been carefully stated in any treatise on Indian banking as yet. It is well known that temporary strain and ease can be experienced at times when taxes are collected and large disbursements on Government item are made. The effects of the flow of revenue and ebb of payments are well known to bankers. At such times it is the bounden duty of the Government to minimise the adverse effects and disorganising influence of its actions on the money market, commerce and industry. This leads us to the discussion of the Treasury balances and their effect on the Indian money market. Although it is true that a Central Bank affords absolute guarantee for the unvarying management of its treasuries under its controlling power and a certainty of greater economy in the use and distribution of its balances throughout the country, still such a powerful banking agency does not exist as yet in this country and the Government is consequently forced to maintain a few treasuries of its own to carry out its financial operations throughout the country. The creation of a Reserve

12 This was the policy in the winter of 1927-28 and the Government supplied emergency currency against sterling securities and against *ad hoc* securities and inland trade bills. This administrative practice on which so much reliance was placed was changed in 1932. The Imperial Bank pledged Government securities on which security the Controller of Currency was giving a loan of 2½ crores.

Bank with few branches does not however alter this situation. The Reserve Bank's credit policy should fit in with a well-planned Government's financial policy. Government's financial policy during times of depression and during times of prosperity should change in response to public opinion.

The Treasury Balances and the Indian Money Market. District Treasuries and Sub-treasuries.

Unlike the British Government which maintains no outlying State Treasuries the Government of India has its funds in District treasuries and sub-treasuries distributed up and down the countryside. Besides these 1,359 outlying State Treasuries, the Imperial Bank of India acts wherever it has a local head office or branch office as the agent of the Reserve Bank which is the sole treasurer of the Government. It does a considerable amount of work on behalf of the Reserve Bank in the management of public funds. The following table shows the cash balances of the Government distributed at the Treasuries and the Imperial Bank [13] :—

(In Lakhs of Rs.)

Balance at Government Treasuries.			Last date of the month.	Balance at the Imperial Bank of India.		
1932-33	1933-34	1934-35		1932-33	1933-34	1934-35
212	241	218	April	715	1,466	766
208	228	206	May	744	713	1,022
207	212	209	June	1,894	567	770
203	198	205	July	1,946	926	773
194	195	188	August	1,394	878	701
206	205	216	September	1,383	711	883
181	215	202	October	826	611	980
205	199	189	November	595	209	710
194	208	189	December	684	624	657
219	214	213	January	838	725	653
240	288	177	February	708	723	732
360	399	388	March	1,099	790	1,285
219	230	213	Average	1,069	287	823

[13] See the Report of the Controller of Currency, 1927-28, p. 10. See the report of the Controller of Currency, 1933-34, p. 63 (statement-XIII).

Two Sections.

Unlike the Government of most other countries of the world the Government of India has to distribute its public receipts into two sections, *viz.*, the Treasury balances in India and the Home Treasury and arrange its prompt disbursements at both centres. Its financial commitments require the provision of funds on a large scale in an external centre. A glance at the following table shows the state of the treasury balances in England as well as in India [14] :—

(In Lakhs of Rs.)

Month and Year.	In India.	In England.	Total.
1st April, 1922	2,566	899	3,465
31st March, 1923	2,596	982	3,578
,, ,, 1924	3,114	1,040	4,154
,, ,, 1925	3,174	1,352	4,526
,, ,, 1926	2,516	1,506	4,022
,, ,, 1927	2,788	326	3,114
,, ,, 1928	916	761	1,677
1st April, 1933	1,459	1,319	2,778
31st March, 1934	1,189	2,088	3,277
,, ,, 1935	1,623	2,102	3,725

The Normal Course of the Treasury Balances in India.

The financial year, which commences on 1st April opens with an "ample balance" which becomes gradually depleted by the end of July. It becomes swollen as a result of the annual rupee loans floated by the Government of India. As disbursements are made the outflow

[14] For more recent figures see the Report of the Controller of Currency, 1933-34, p. 61 (statement XI).

becomes again greater than the inflow with the result that the Treasury balance is reduced to the lowest possible limit in November and December. From January the revenue collections begin and the earnings of the commercial activities of the Government also improve during the busy season and the treasury balance in India gradually expands till the end of the official year. When the tax collections are made "the public deposits" of the Reserve Bank and the Treasury balances expand and the reverse operations of paying back the treasury bills and payment of interest on public debt would release the funds and there would be an augmentation of "private deposits" and purchasing power in the hands of the public. The accumulation of cash balances in the hands of the Reserve Bank at the last quarter of the financial year when it also happens to be the busy season of the year tends to enable the Reserve Bank to earn huge profits and if the tendency of the public is to issue cheques in payment of taxes to the Government it would create a shortage of credit when the ingathering of revenue takes place on a large scale during this period and the Reserve Bank would soon control the credit situation and the money market at such times.

Reasons for abnormal variations.

This average sum of the cash balances in India may be disturbed if abnormal variations occur during the course of the financial year. Some of the important causes for the variations or fluctuations of the cash balances in India are so well-known that any detailed mention is unnecessary. Any stoppage of the sale of Treasury Bills and undue retention of the proceeds of the rupee loans till they are used for the specific purpose for which they are floated, the slackness of trade demand for remittance which means lack of opportunities for remittance to the Home Treasury through the money market and the making of the bulk of the remittances in the earlier portion of the financial year than it is usual to do, are the chief reasons for the abnormal variations of the cash balances in India. The first two causes lead to larger treasury balances in India and the Secretary of State's Home Treasury may be augmented through the currency channel. The last-mentioned feature depletes the cash balances in India and causes an accumulation of the same in the Home Treasury.

Effect on the Money Market.

The maintenance, in a modified form even, of the treasury system would withdraw funds from the money market and unless a systematic banking use of these funds is made it is apt to increase and aggravate other causes such as seasonal variations. Sound monetary conditions postulate the greatest possible economy of Government balances lying outside the banking system. A trustworthy banking agent should be in charge of the Treasury operations.[15] So long as public deposits at the Treasury are kept idle they are not available for trade purposes. Hence a prompt release of these funds into the hands of the bankers is necessary to avoid high money rates in the money market. As Mr. (now Sir) Hilton-Young points out, " It is a part of the good Government to avoid making credit scarcer and dearer by temporary accumulation of money in the hands of the state. A Government has no business to take out of the pocket of the taxpayer and keep lying idle more of their money than is absolutely necessary for its immediate purposes. All possible measures should be taken to keep public deposits at all times as low as possible. Care in that is more needed every year. The business of Government and the number of the state's activities steadily grows and with them grows the size of the revenue of the various funds with which the Government has to deal. Under these conditions without constant vigilance to prevent it there is some danger that an increasing burden may be cast upon the industries of the country by the accumulation of an increasingly large balance of the Governments." [16]

Government Measures to reduce the strain.

The remittance operations of the Treasury need not be referred to in detail. It must be admitted that the Government of India has been

[15] The Government receives money in the different places in the interior and has to remit these resources to headquarter cities for expenditure purposes. The traders have to make remittances to secure produce. These requirements are dovetailed into each other. Traders secure remittance orders from the Government which makes a small charge for supplying bills or telegraphic transfers through the currency chests. A large amount of remittances is made through this channel without any actual movement of coin. See Mr. Gillan's Report on Currency Operations in 1910-11 and the reports of subsequent years.

[16] See Hilton-Young, "The System of National Finance." pp. 303 and 304.

doing its level best to economise the treasury balances and keep them as low as possible. Since 1921 it has been the consistent policy to empower certain sub-treasuries, to withdraw funds without previous sanction and the transfer of funds was facilitated largely by the opening of currency chests alongside the sub-treasuries and providing facilities for remittance through the currency chests.[17] The opening of more branches of the Imperial Bank and absorbing a greater portion of the Treasury work has also facilitated the problem to a great extent. These efforts have tended to throw a large portion of the funds which accumulate at the 1,359 outlying treasuries back into the hands of the Reserve Bank and the Imperial Bank which are in constant touch and contact with the money market and the Reserve Bank performs work for the Treasury practically without any charge.

Low Cash Balances in India.

The accumulated funds in the Treasury in India and the Reserve Bank constitute a part of the cash balances of the Government of India. These form the Indian portion of the cash balances. In the event of expenditure becoming greater than the accumulated revenue, the Government of India has devised three steps to tide over the particular situation, *viz.*, (1) The Reserve Bank tries to help the Government by granting the ways and the means advances out of its own credit reservoir. But two peculiar and changing features of this method have to be noticed. Firstly, the Reserve Bank would be in a position to grant substantial sums as its balances now are generally of a very substantial character. As it is endowed with the privilege of note-issue it can count upon its own working capital which consists of its paid-up capital, notes, reserves and depsits. Secondly, the ways and means programme of the Government of India is not any exact estimate of the requirements and the methods adopted to acquire the necessary resources to meet the expenditure. As Sir B. P. Blackett, the ex-Finance Member, points out, "Our ways and means budget is intended to be and necessarily must be illustrative rather than exact. The

17 The currency chests facilitate the remittance work of the Treasury by making it easy to have mutual transfers between the two. The mobility of the reserve is enhanced greatly by this measure.

ways and means figures bring together the net results of operations of very varying character all over India, Burma and London. To a large extent these operations are either not under the control of the Government of India at all or only very indirectly under their control. In these circumstances it is neither possible nor desirable to attempt to lay down a rigid ways and means programme far in advance. The only result of so doing would necessarily be to swell our balances needlessly." [18] Thus it is apparent that the Government's policy is to avoid unduly large balances and try to meet the deficit in the best possible manner thrown open to them at any particular time. This method of securing advances would be resorted to in case of sumptuous balances in the Reserve Bank.

The sale of treasury bills by tender with intermediates at fixed rates between the weekly tenders is another expedient borrowed from the British financial practice. As a temporary borrowing this method is resorted to and as soon as revenue realisations are made the treasury bills are paid off on maturity. But both ways and means advances and treasury bills would reduce temporarily the purchasing power of the public if it is the latter that absorbs the treasury bills. If they are largely held by the financial houses, like the Calcutta Discount Company, brokers and banks, an equivalent amount of purchasing power is not cancelled.

Another former expedient of increasing the Government cash balances in India was the practice of issuing currency notes against British Treasury bills or sterling securities purchased by the Secretary of State for India and deposited in the Home branch of the Paper Currency Reserve. During 1923-24 there was an addition of twelve crores to the cash balances in India according to this method. Again in 1924-25, there was a similar transfer of balances from the Home section to the Indian portion by buying 6 crores worth of B. Treasury bills which were placed in the London branch of the P. C Reserve and currency notes released into cash balances in India By re-transferring a portion of the cash balances from London to India the Indian resources were largely augmented. The Reserve Bank should see that sufficient balances alone are remitted to the Secretary of State in London.

18 See his Budget speech, 1926-27.

So long as the independent and separate treasury system is maintained *even in a modified form* it is incumbent on the Government to see that its operations do not act in any way to the disturbance of the money market. It has also been pursuing the policy of transferring its home balances to the Indian portion in case the latter needed any augmentation. Of late, it has been pursuing the policy of selling T. Bills with the avowed intention of levelling out inequalities in Government revenues and disbursements throughout the year and save interest charges by reducing the average Government balance. The other indirect advantage of the sale of T. Bills also prompted the Government to reintroduce their sale. Improvement in the financial facilities of the market and the checking of seasonal fluctuations in the value of Government securities were the indirect objects aimed at by the reintroduction of the sale of the Indian T. Bills. Undue piling up of Government balances must always be avoided by paying out the same immediately. This is what the Central Banks of other countries do in the matter of their T. Balances.

Some Peculiar Features of the H. Treasury.

The Home Treasury has certain peculiar features of its own which would have to be noticed in any analytical study of the Government Treasury operations on the money market. The first peculiar feature is that there is no rise and fall as in the case of the treasury Balances in India. Secondly, it earns interest and, as the Hilton-Young Commission admits, " unduly large accumulation of funds were made in London as they could be remuneratively employed in the London Money Market." [19] The third peculiar feature is that there can be no transfer of heavy balances in India which gather in January to April to the Home treasury as the busy season in the money market coincides with the period of gathering heavy revenue realisations. Relief to the M. Market is essential and so a portion of heavy balances in the Home Treasury can be transferred to India in October, November and December. We have already seen how this is accomplished by purchase of B. T. Bills or sterling securities and

[19] See the Report of the Hilton-Young Commission, p. 46, para. 112.

placing the same in the P. C. Reserve in London and releasing currency notes against the same to the cash balances in India.

The Necessity of the Home Treasury.

The necessity for accumulating the Home Treasury in London is primarily to arrange for the disbursements to be made in the United Kingdom on behalf of the Government of India. Annually about £35 to 50 millions would be required for the needs of the administration under this heading. Remittance of this sum has to be done without disturbing the money and exchange markets. If the T. balances in India are slender it precludes the possibility of remittance on a large scale and the Home Treasury would be lean or slender...The Secretary of State for India can fall back upon sterling borrowing to secure the needs of the administration. But if treasury balances are heavy in India part of the same can be remitted to London with the result that the H. Treasury would have sumptuous balances. Again when the whole of the capital requirements are secured by floating rupee loans the Home Treasury balance would be lower than when a part of it is being secured by floating sterling loans.

Remittances to the Home Treasury.

The problem of annually remitting such large funds on behalf of the Government of India would have assumed grave consequences to the Indian money market but for the fact that there is a heavy counter demand for remittance from England to India. Whenever trade demand for remittance is keen the Government remittance becomes the only important cover available to bankers during the days of busy export trade and when private remittance is anaemic the bankers fall back upon Government remittance. As this is the present tendency underlying Government remittance it is impossible to forecast the dates and amount when the remittances would be made.[20] Sir James

[20] It is not only for the augmentation of the Home Treasury so as to enable it to meet the needs of the administration that remittances are usually sent but they are required on behalf of the home branch of the P. C. Reserve which was formerly opened in 1905. See also Act No. XX of 1923 for the composition of the metallic reserve of the Government Paper Currency. Both gold as well as sterling securities can be held in London.

Brunyate wisely remarks that any such forecasting requires " not only the statistician's gift of estimating but that of prophecy would be required to fix the size of the Home Treasury balance." It was not this difficulty alone that often led to unusually heavy cash balances in the Home Treasury but the possibility of earning interest tempted them to pursue this procedure but unfortunately it only tended to the raising of the Indian bank rates to a high level which could have been avoided to a certain degree. Heavy Home balances may be a source of comfort in days of weakening exchange and can be reckoned as a prop to weakening exchange. But its effect on the Indian money market has already been related.

Present-day problems of low cash balances.

The low treasury balances in India mean low cash balances of the Reserve Bank. Sumptuous cash balances of the Government mean fat balances for the Reserve Bank at the same time. Again when the money does not return promptly from the up-country centres and a hold-up takes place the cash balances of the Reserve Bank would be very low. If such low cash balances were the chief features at the beginning of the season (December to March) as it was the case in 1928 it meant resort to the Controller of Currency for P. C. Notes against hundis. The peak months of the busy season are December, January, February, March and April. If the demand for the marketing of jute, rice, wheat, cotton, tea, hides and skins and the spring crops of north India were to be keen, the chief feature would be high money rates. They may be raised early in the month of December. Formerly internal bills were placed in the Controller's hands to secure emergency currency. Although a high bank rate might prevail the market rates may be made easy if the Government or its agent the Reserve Bank purchases sterling and maintains the floating supply of credit. Money conditions may continue to be tight during the busy season but there would be no acute stringency for the repayment of treasury bills would ease the market situation to a great extent. Rediscounting at the hands of the Reserve Bank would ease the situation greatly.

But if the demand for financing the movement of crops were to cause no heavy pressure on the Reserve Bank it spells stagnation of

trade. Activity and profits from the commercial activities of the Government would fall to a low level. Railway finance would be the chief sufferer. The total revenue realisation of the Government would be smaller. As only one-third of the budgeted requirements of the Secretary of State is generally secured during the slack season by purchase of sterling in India the remainder cannot be secured easily ; in which case resort to temporary sterling borrowing would be inevitable. If very low cash balances were to be the chief feature the remittance programme cannot be completed as it would be dangerous to purchase sterling on a free scale with depleted cash balances in India. It is unnecessary to carry this analysis further but sufficient indication of the underlying complications in the subject, which is discussed so much and understood so little, has been made.

Such consequences would be repeated every year so long as there are low cash balances in the hands of the Reserve Bank at the beginning of the busy season. It is high time to cure this inelasticity of currency and credit during the busy season. Seasonal variations cannot be adequately provided for without an efficient Central Bank of Issue consciously managing the currency system in the wider interests of the country. This is the way in which the Dominions of the British Empire have solved their emergency currency problems arising out of seasonal variations for currency.

Concluding remarks showing the necessity of reorganising the Banking system.

The maintenance of low non-bankable cash balances in India is a desirable end by itself. This can only be achieved by exact estimating in India and at Home and there should be close correspondence between the actuals and the estimates. Under-estimates of expenditures would have to be avoided. Otherwise, undesignedly high balances would accumulate. If kept in the hands of the banker it would at least condone to a certain extent the evil effects of undesignedly high balances. A balanced budget will not certainly introduce great disturbances in any direction in the money market. Temporary displacements when the in-take and out-go of Government revenues are made would not seriously affect the money market.

Again a full banking use of the treasury balances should be made. The creation of a Central Bank of Issue would undoubtedly simplify these problems and the duty of the Central Bank would be to manage the whole of the treasury work of the Government of India. The problem of any unintended surplus has to be dealt with in the first instance. It is unwise to make use of this as the basis for the superstructure of credit, for any realisation of the same would be impossible in the near future and trade cannot be made to depend upon this unexpected source which may be cut off at any time. The remittance function would undoubtedly be handed over to the Reserve Bank and the provision of the Secretary of State's requirements according to periodical forecasts supplied beforehand to the Reserve Bank is to be left purely to the discretion of the Reserve Bank. Previously when remittance was made through the currency reserve when it could be made through the Treasury balance it produced inflation and a corresponding deflation had ultimately to be made. It is only a Central Bank of Issue with a vast reservoir of credit that can make the Treasury actually independent of the money market and rescue the Treasury in periods of emergency. It is a Central Bank of Issue alone that can cope with the exacting requirements of a Government which keeps small balances and carries on enormous number of banking transactions.[21] We earnestly hope that the Reserve Bank of India would co-operate with the Treasury at all times and seasons of the year.

Another peculiarity of the Indian foreign exchange market is that it is greatly susceptible to influences arising out of capital movements, *i.e.*, the inflow of foreign capital into the country. The supply of investible funds in the internal capital market within the country would reduce the interaction of the international investment market on the foreign exchange market of this country. There is a great demand for the investible savings in the country and the supply

[21] The Government not only refuses to pay a charge but expects conducting increasing financial operations with smaller balances than before when the volume of Treasury operations was small in comparison. The same is the case with most of the States. So the problem of relationship between the state and the money market is always considered a "troublesome one" quite "as troublesome as the relationship between the state and religion."

See Burgess, "The Reserve Banks and the Money Market," p. 92.

cannot be easily adjusted to suit the demand. Inasmuch as the supply of savings cannot be immediately increased even though an attractive yield is offered the demand factor has to be regulated, but in the absence of issuing houses specialising in underwriting business the regulating of the demand cannot be done effectively. Both the Foreign Exchange Market and the Investment Market are alike imperfect as a result of the loosely organised money market, absence of rediscounting feature and lack of C. Banking policy. It is for this reason the writer has suggested the formation of a National Board of Investment to regulate demand as well as supply of investible savings on the part of the community. Excessive speculation is a danger in the investment market which requires prompt control. Speculation in stocks and shares is a great danger to credit stability and it should be one of the duties of the Reserve Bank to check speculation in the investment market. It is folly to sit quietly without perfecting the internal capital market on the plea that its perfection would only mean organisation of British investment.

But the main point is that with the present undeveloped money markets that are existing now we cannot hope to regulate credit in such a way as to correct the tendencies in the foreign exchange markets. As a variable gold standard system is to be ushered in under the management of a C. B. of Issue the real causes for the adverse movements of foreign exchange or the underlying motives for speculation on stock market should be studied. Lest these culminate in a draining away of gold from the country the Reserve Bank must be in a position to make such movement as not only tend to prevent the loss of gold but counteract effectively the underlying causes initiating the adverse movements in the foreign exchange and the investment markets. India's balance of payments is becoming attenuated slowly as a result of the doctrine of national economic self-sufficiency being pursued by the other countries. As gold exports cannot take place for all times to come, the annual foreign obligations of this country would have to be curtailed greatly. The development of the internal capital market would reduce the interest payments we have to make annually. Trade pacts to extend the export trade of the country would have to be concluded. It is the duty of the Reserve Bank to keep a proper watch on the different items of the balance of payments.

India's vast size.

Before discussing the general characteristics of the busy and the slack seasons it must be realised that India is a vast sub-continent. It is quite natural that the seasonal variation should occur at different times in the different parts of the country. The following table originally adopted by Mr. M. F. Gauntlet, Controller of Currency, in his report for the year 1912-13 shows the busy and slack seasons in each currency circle [22] :—

Month.	Eastern India.		Western India.	North India.		South India.
	Rangoon.	Calcutta.	Bombay-Karachi.	Cawnpore.	Lahore.	Madras.
Busy	3 months	3 months	7 months	8 months	10 months	6 months
Slack	9 months	9 months	5 months	4 months	2 months	6 months
January	Busy	Slack	Busy	Busy	Busy	Busy
February	,,	,,	,,	,,	,,	,,
March	,,	,,	,,	,,	,,	,,
April	,,	,,	,,	,,	,,	,,
May	Slack	,,	,,	,,	,,	,,
June	,,	,,	Slack	Slack	Slack	Slack
July	,,	,,	,,	,,	,,	,,
August	Busy	Busy	,,	,,	Busy	,,
September	,,	,,	,,	,,	,,	,,
October	,,	,,	,,	Busy	,,	,,
November	,,	Slack	Busy	,,	,,	Busy
December	,,	,,	,,	,,	,,	,,

[22] Compare the table with Dr. Ambedkar's table given in his "Problem of the Rupee," p. 60. Both the tables agree so far as Rangoon and Madras circles are concerned. Dr. Ambedkar estimates 4 months—August to November—as the busy season in Calcutta. Coming to Western India he is of opinion that the busy season is from November to March ranging over a period of six months. So far as Cawnpore is concerned he estimates the busy season to extend over 6 months only, September to November and February to April. Finally the busy season in Lahore extends to 9 months, from January to June and October to December.

General characteristics of the busy season.

The main characteristic of the busy season is the tightness of the money market, for the outflow of money is greater than the inflow. There is brisk demand for money and diversion of funds from the money market for the financing of the movement of export staples, such as jute, cotton, seeds, wheat, rice and the spring crops of Lahore and Cawnpore. Roughly sixty per cent. of these crops are meant for export. The jute season commences early in August and money returns back to the port centres in December. The cotton exports have to be financed from October to February and the call for financing the rice crop comes during December to March and last comes the call for financing wheat, oil-seeds and the spring crops of North India. A late jute crop and an early cotton crop or a heavy demand for these Indian products or too frequent transactions in them or a high price of these products would lead to a heavy demand for currency,[23] either in the shape of cash or currency notes for moving the crops from the up-country to the port centres. Hence there are low cash reserves and stringent conditions prevail in the money market. The Imperial Bank of India in order to protect its own cash reserve used to raise the bank rate to a high level. It is not this harvest demand alone that constitutes the main demand for currency. There is the marriage season at which period also there is heavy demand for currency.[24] The mid-summer indolence usually gives

[23] See M. M. Gubbay's evidence before the Babington-Smith Committee, Volume II, p. 86. See also the annual reports of the Controller of Currency which give the readers an idea of the currency needed for financing the chief export staples.

[24] Stringency in the Indian Money Market might sometimes be due to want of confidence in exchange, precariousness of credit and consequent withdrawal of native capital from circulation in the bazaar. As these are abnormal features occurring now and then they cannot be considered normal features of the busy season of the country. Stringency may be due either to sudden and heavy demands arising in abnormal times as war, plague or famine when the normal capital supplies would be found insufficient. Again it may be due to sudden contraction of normal capital supplies while demand happens to remain the same. It is a peculiar characteristic of India that both demand and supply vary very greatly. Fluctuations in money rates would be greater in this country than anywhere else. Indian banks cannot hope to control all the different conditions. They cannot hope to remain so steady as those of the western countries where reasons for the credit strain or disturbance can be foreseen and prevented by timely action.

place to abounding vitality of fulsome activity. Bankers do not sit yawning behind their desks as they do in the monsoon months. The financial circles become active. There is life, vigour and fulsome activity in the busy season.

General features of the slack season.

In the slack season there are plethoric credits, large cash reserves, huge floating balances and low money rates. Short-term money tends to become an "unusable drug in the market" as the Exchange Banks put it. Although this is an exaggeration there is always a super-abundance of short credits. Investment in bullion and Government securities preponderates during this season and the purchase of imports is also undertaken. The Exchange Banks not finding it possible to lend even at 3½ % generally undertake exchange operations, *i.e.*, buy gold exchange ready and sell forward gold exchange so as to bring it back in time for the ensuing busy season. The three summer months during the year constitute the period of the slack season and as they are the monsoon months weather conditions restrict the activity of the people in all directions and there is [5] enforced leisure. The demand for currency falls to a minimum during these three months. As Sir Basil Blackett [26] points out "monsoon increases the wideness of the margin between the amount of currency and credit required when activity is at its maximum and the amount required when the activity is at its minimum during the year. Hence it is absolutely inevitable that money should be cheap during the summer months in India which constitute the slack season. During that period money should be kept liquid in order

[25] Again another important feature is the abnormal need for cash or currency in this country. In the western countries cheques and credit instruments are used largely for transactions in foreign trade, security transactions and freight movements. It is only for wage payments and family expenditure that hand to hand currency is demanded. The lack of detailed figures of a Central Bank of Issue would not enable the student of Indian banking to follow the weekly currency movement and nothing beyond facile generalisations as regards the size of the currency operations are offered even in the case of the annual report of the Controller of Currency.

[26] Quoted from his speech delivered at the opening of the Calcutta branch of the C. Bank of India, July 21, 1924.

that it may be available for use during the winter and spring.[27] These are the peaks and valleys of credit occasioned by the character of business of this country [28] and to these fortunes and fluctuations of the money market must be added those produced chiefly by the financial operations of the Treasury.[29] The great fluctuations in the volume of Government deposits and the heavy remittances to London, the inflow of funds on account of Government payments for redemption of their Treasury bills or the repayment of the ways and means advances to the Reserve Bank, have their effect on the internal credit situation in this country. The rigidity of the credit system leads to heavy and penalising rates that are imposed on businessmen and the agriculturist suffers because he has to sell at a time when a tight money market depresses prices. The agriculturists and the buyers of imported commodities have to buy their supplies when easy money conditions tend to raise prices. The bankers feel the burden of great financial anxiety when they begin to tie up their resources in the slack season in purchase of Government bonds and are always haunted by the night-mare of possible depreciation of capital. Stabilising the money market consists in the elimination of these baneful characteristics.

27 Of late the machinery for contracting currency in May and June is systematically put into operation. The fall in exports and the return of rupees from circulation point out the redundant nature of currency. The P. C Reserve is utilised for these operations. Transfer to the Home Treasury of the Secretary of State of sterling securities, withdrawing of the rupee securities from the P C. Reserve and the repaying of loans by the Imperial Bank to the Controller of Currency would lead to contraction of paper currency and during 1927-28 the P. C. Reserve was thus operated upon to bring about the desired contraction from 184 crores to 171 crores at the end of May.

28 The most noticeable thing during recent years is the absence of the seasonal bulge of the exports. This is due to the purchasing tactics of the overseas buyers and the staying capacity on the part of the producers to carry over the produce for a longer period in anticipation of better prices. These factors are tending to mitigate the downward torrent of exports from up country into port centres during the busy season alone. They are being exported now in slowly moving driblets all throughout the year. This partly explains why the bank rate tends to be high even in the so-called slack season.

29 The present Government policy is to cause the minimum inconvenience to the Indian money market. Although Treasury bills are to be floated in the money market an attempt is to be made at the same time to release the money through purchase of sterling if tightness of the money position were to ensue as a result of the sale of the T. Bills. The economising of the Government Treasury balances is also a noteworthy feature of Government's recent financial policy.

Some Noticeable Features of Banking Practice.

Before indicating any method for improving the money market some of the general differences between banking practice in India and that of other countries must be pointed out. An understanding of these features is absolutely essential for true wisdom consists in successfully adapting these features so that an improved banking system can be created in this country. We resemble the United States of America in having widely differing regions whose special necessities have been recognised in the formation of a Central Banking institution for the country. As in the United States of America, so also here, the regional offices and branches of our Central Bank can be made to help each other in case of need. When additional money is needed in the jute area the Bengal office or branch can send bills to the Madras office or branch for rediscounting or when the cotton crop has to be moved in the South bills can be sent to the North Indian office or branch for rediscounting. Cash can thus be liberated for helping the sister offices and branches. A decentralised Central Bank plan on the model of the Federal Reserve System of America would enable this to be done more efficiently than a single Central Bank with no regional offices and Local Boards in the interior of this vast sub-continent. It is a matter of gratification to the author that the above advice which has been offered long ago has been accepted in the formation of the Reserve Bank's constitution.

In the European countries they have a Central Bank with branches in the different centres. In India we have very few big banks covering the whole country with a network of branches. The U. S. A. resembles this country in this matter but it is more fortunate in having a very large number of small independent unit or local banks not scattered in squads but marshalled in armies under the leadership of the F. R. Board whose democratic organisation enables its operations to be dedicated solely for public service. Both the Acts of 1933 and 1935 have strengthened the credit controlling powers of the F. R. Board of America. Indian people do not make wide use

[30] The flow and movement of cash in India is also slower than in the case of other countries. Hence commerce and trade need more cash basis in this country than anywhere else.

of cheques and bills of exchange in the matter of domestic movements of goods as people of America or England generally do. In this respect we resemble Germany and France though of course their use of credit instruments is much greater than ours.[31] Consequently there is no bill market nor is there the habit of rediscounting on the part of Jt. St. banks. India is the only big commercial country where amateurs are allowed to conduct banking business with impunity.[32] It is not traders and industrial concerns alone that carry on banking but the European firms, shop-keepers and private individuals carry on deposit—attracting business offering to pay very high rates of interest. Commerce, trading and industrial management are not compatible with successful banking. The Government have not cared to check the various practices by refusing to permit outsiders to deal with legitimate commercial banking business. Viewed from this standpoint banking can be defined in this country as the giving of monetary credits.

The Indian Jt. St. banks generally undertake commercial banking business of a very conservative character. Investment banking is generally also taken up along with commercial banking by the European continental banks. In England and America there are special agencies for underwriting. Foreign Exchange business is a more important part of the business of the European Banks than indigenous joint stock banks. Herein our conditions approximate more to those of the National Banks of U. S. A. which prior to the recent war, conducted purely domestic banking business alone. We have copied the Scotch system of cash credit to a certain extent and

31 Till 1920 there was no Clearing House in France. The Chamber de Compensation was organised in Paris in 1920. Deposit banking is in its infancy and payments are made by bills of exchange which are drawn for very small amounts and the bills are generally made payable not at the bankers', but at the acceptor's house. In 1914 deposits in twelve leading French banks including the Bank of France amounted to approximately 5,000 millions francs while the circulation of notes, gold and silver amounted to approximately 12,500 millions. In England the notes and gold amounted to roughly £160 and bank deposits to roughly £1,100 millions. See D. T. Jack, "Restoration of European Currencies," p. 113. Even taking Germany into consideration the cheque system of payment was not very popular before the recent war and the Government had to exercise much pressure in this direction.

32 See the article "India's Amateur Banker," Bankers' Magazine, London, August, 1925. He points out that 3½% is allowed on 12 months' fixed deposits.

the practice of overdrawing is generally allowed in the European countries. In America the tendency is to base each loan on a definite instrument. The Indian banks generally require their loans to be based on the general credit of the borrowers and the cash advance account predominates. Even the indigenous bankers finance trade largely by the book credit system. Here again we do not seem to be following the recent tendency of the American Banks which insist on the creation of a large number of negotiable instruments that can be rediscounted at the Central Bank. Unless this practice is changed in our country rediscounting at the hands of the Central Bank would be an impossible feature. Nor will the acceptance market develop in this country so long as the cash credit account is considered beneficial to banks as well as borrowers.

Is there no autonomous money market in India ?

Some critics contend that a thoroughly organised money market does not exist anywhere in India. There is no autonomy of the Indian money market. The upholders of this view point out that the Indian money market's dependence for funds is undoubtedly a proof of its subordination.[33] Isolation, absence of specialisation and differentiation of function still mark our financial organism but like the human organism itself the financial organism attains its perfection while passing through evolutionary stages. The Indian money market has necessarily to pass thorough these periods of transformation before it can finally evolve as a perfected and thoroughly organised institution.

[33] It must however be remembered that London is the world's financial centre and natural leader of the world in regulating credit and is about to re-establish her old supremacy in this direction. The predominance of the London Money Market as the world's loan centre is chiefly due to the underwriting business undertaken by the British investment companies. They have also sometimes undertaken the underwriting business of industrial companies. By rebuilding her great economic strength Great Britain is adding to her net foreign holdings. There is also the resumption of a free gold market. The continued division of labour in the highly organised money market, the regaining of her old customary channels of credit and the pursuing of free banking as in the pre-war days have enabled London to regain her lost monetary leadership and the golden sceptre of finance." Hence London's credit policy would affect all money markets whose operations are closely intertwined with hers.

Stages in the evolutionary development of this money market.

The first and incipient stage in the evolution of the money market is the collection of the credit material. It has to be aggregated into huge masses by the great banks, the savings banks and the co-operative credit societies.[34] The Insurance Companies have to play the part of subordinate adjuncts and trustworthy lieutenants in the process of accumulating money. Money should be tempted out of the small dormant hoards andthrust into useful activities. The supply of capital should be increased and adjusted to the demand. It should be made mobile and fruitful. This is the duty of our banks and they should try to equalise supply to demand. They should avoid plethora of money at one time or a modicum at another. They should enable the businessmen to make plans years ahead with every assurance that they can continue their financial operations without being penalised by high money rates.

The next stage in the evolution of the financial organism is reached " when there is a conscious directing of functions and proper co-ordination of them. It becomes conscious of itself, aware of its own existence ; tries to protect itself and to guide and control its own future. It is in this intermediate stage, an era of experimentation, that mistakes, miscalculations, reverses and misjudgments may be committed and the financial organism may be put to a trial now and then but on the whole it endeavours to correct itself and advance on the right path and produce the machinery needed for serving the public need." Then only can the financial organism evolve as " a perfect and thoroughly organised whole with proper correlation, interconnection and due juxtaposition of the several elements to each

[34] More Life Insurance Companies have arisen in this country lately. Many more have to be created so as to stop the great outflow of profits which amount roughly to 10 crores of rupees per annum, which foreign banks and insurance companies have been realising in this country. It would indeed aid the industrial and financial system of our country to a great extent. It must be pointed out in this connection that some of the Exchange Banks discriminate between the European L. I. Companies and the I. L. Companies and refuse to accept the policies of the latter as good security. Unless more life insurance companies arise and pursue a policy of sound investment in public utility industries the industrial progress of the country would be handicapped. Both the American and Canadian L. I. Companies invest largely in Railway companies and immovable property as land mortgage.

other." [35] The early money market of New York was only an "amorphous structure" out of which have crystallised the various institutions existing at the present time. Each developed in turn as the demand for that type arose. The investment market, the commercial paper market and the foreign exchange market, arose in this manner. The call loan market was later on developed to meet the demand for stock-exchange borrowing. "The evolution of the market," says M. G. Myers, "has followed the law of evolution in general and has been marked by continuous differentiation of function."

According to this theory of evolution the Indian money market is slowly passing through the first stage. There is accumulation of credit material going on. More banks should arise to mobilise our money power. The various subordinate adjuncts have to perform their mission faithfully and efficiently. The advent of specialisation and the differentiation of functions among the component members of the money market are noticeable to a certain extent but as yet no signs of calculated co-ordination are visible.

The stabilisation of the money market.

This catalogue of miscellaneous imperfections and defects of the money market might carry conviction that the banking system and the money market are honeycombed with imperfections and need improvement in detail. Even the Foreign Banking Experts testify to the truth of the above statement. Systematic attempts should be made to reconstruct the money, foreign exchange and investment market in the way outlined in the succeeding chapters. A well-organised system of finance would have to be built up. The oppressive influence and incubus of the money-lenders must be eliminated. The credit system should be thoroughly organised. Credit has to be made cheap yet not facile. The paralysis of the existing credit system due to the insufficiency of the existing banking institutions has to be rectified. All sides of credit, *viz.*, long-term, intermediate and short-term credit, both for agriculture and industries, should be specialised by the

[35] Dr. E. Powell, "The Evolution of the Money Market."

existing banks. The habit of thrift must be encouraged. The folly of improvidence should be checkmated. The various sections of the people have to be devoted to the study of the credit situation in our country. Cheap and easy credit ought to enable the agriculturists to become prosperous. As Sir Daniel Hamilton says "the present vicious system of finance by the money-lender sterilises the beneficent work of the Government." Real, legitimate and productive credit should be created to ensure success in commerce, agriculture and industry.

Many more banks can be started without any detriment to the existing ones. The present joint-stock banks are of great value so long as they have plenty of resources and are ably and skilfully managed. The co-operative bank is an essential requisite for every village and more of these wonder-working institutions should be created. Other types of banks which provide cheap and effective credit have to be started and they will find their due place in a fully organised credit system of our country. Their operations for a few years will enable them to consolidate their business and there will be a shaking-down into their clear-cut functional activities of the different kinds of financial institutions with which India may be blessed in the near future.

The saving energy of our people should be stimulated and directed into a broad stream of national finance. The extension of banking facilities, and the stock-exchange and investing agencies of various orders, coupled with the ever-increasing publicity of the press and telegraphic facilities for communication of news and transfer of payments would increase the little driblets of savings and turn them into a broad and navigable stream of finance which has to be carefully distributed over all parts of the country with increasing rapidity and accuracy of judgment. Our investors should send solid and concrete capital to tap every corner of our country to find natural resources for profitable exploitation. It is their bounden duty to alter the financial status of our country from an international debtor country into that of an international creditor country.

The main function of our credit institutions is to stimulate and collect the savings of the people, call forth habits of thrift, economy, and prudence, guide their outlay into productive channels and stimulate productive activity of the people. Unless a wisely-planned banking

system exists developing the money power of our country political or social reform will be of no avail. Sir Daniel Hamilton correctly prophesies that "without a banking system which will develop the money power of the country the reform scheme or any scheme becomes a dead letter and the new legislative council a farce." The development of the banking system is something which is incumbent upon us all as citizens of this country and it would be a patriotic act if we all registered a vow to enlighten ourselves fully upon our duties as citizens in respect of our understanding of the financial matters of the country.

A banker is not a mere parasite on the real owners and producers of a country. It is not the business of the banker to augment the capital of the country.[36] The Indian bankers' sole duty is to stimulate private savings and its investment in interest-bearing securities instead of the present barren type of locking up cash in gold or ornaments. The banks have to create interest even in foreign securities. It is this movement that is going on in the United States of America as a result of which the Government bonds of the South American republics and European countries are sold in the investment market. Even industrial securities like those of the *De Beers consolidated Mines* are also absorbed by the American investors. German bankers similarly created this taste in the German public with the result that the pre-war German investments were to be found in Spain, Switzerland, Italy, the United States of America and South Africa. Even securities of oriental origin were bought eagerly by the German investors. Opportunities arose several times to reduce India's foreign obligations but these were not availed of. During the past five years the Government of India have purchased £50 mil. in excess of normal requirements but even these were not utilised to reduce India's foreign obligations. Instead of this they have floated additional loans of about £10 mil. net on an annual average during the past four years.

An improved credit system can solve some of the currency ills of our country. The much needed elasticity in our currency system can

[36] Adam Smith says, "all that the banker has to do is to make capital more active and productive than it would otherwise be the case. It is by this means alone that the judicious operations of banking can increase the industry of the country."—Wealth of Nations, edited by McCulloch, p. 257.

be obtained. When once the issuing of notes is handed over to the Central Bank the note-issue will enlarge for more facilities for their encashment will be provided. Banking extension makes for economy in metallic reserves in so far as they are needed for domestic exchange. The highest currency ideal is to circulate a paper token instead of full-value metallic coins and the best way of approaching this ideal is to circulate bank notes. A widespread banking system would be an effective counterpoise to the hoarding tendency or unwise locking up of savings in the shape of gold or silver ornaments.

The intelligent guidance of the Central Bank.

The creation of the Reserve Bank would undoubtedly give a new turn to the banking wheel and perfect the organisation of the Indian Money Market under its intelligent direction. This concentration in a single hand of the functions of the currency authority and credit-controlling duties of the C.B. of Issue would render it possible to undertake more vigorous steps for the perfection of the Indian currency and credit system. The control of credit should be so exercised that seasonal disturbances of currency due to the need for lifting and moving the crops are not tending to produce disturbances in credit. The currency law must make adequate provision for due seasonal expansion of credit currency at such times and the Central Bank by virtue of its surplus reserve should always be in a position to satisfy the extra demands for credit.

Inaugurating a new era of closer co-operation and greater cohesion among the different banking institutions of our country and arriving at a common understanding of their mutual aims and better realisation of their interests it should bring about unity where hitherto discord and jealousy have reigned triumphant. With the cessation of unfair and cut-throat competition among the different banking institutions of our country a glorious future awaits all our productive industries and the banks themselves are bound to reap their own share of profit. As they sow, so will they reap. The Reserve Bank itself should favour a continuous policy. With a broad basis of administration it should attempt to secure better co-ordinated domestic service

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on the part of the reorganised banking system. Mobilised reserves, a unified system, common control and co-ordinated banking policy ought to be the primary aim of the banking reformer. These have to be secured to a great extent without at the same time making the banking system a Government affair as it has been the case in the U.S.A.

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CHAPTER II

A Central Bank of Issue

(*Historical and Theoretical.*)

The necessity for a Central Bank—The example of other countries. Impossibility of decommercialising the Imperial Bank—The organisation of the C. B. of Issue—The working model of the Bank—The work of the C. Bank—The practical difficulties in the path of the new C. B. of Issue—The future of the C. Bank of Issue.

The history of Indian Banking from the year 1807 has been that of a long unsuccessful struggle for an efficient Central Bank. When in 1928 Sir Basil Blackett took up earnestly the task of adapting the recommendations of the Currency Commission to the needs and exigencies of the situation in India it seemed as though we were nearer the goal than in the last century or at any subsequent period. Unfortunately the joint opposition of European interests [1] and Indian businessmen and politicians led into one deadlock after another and in utter despair the scheme was given up on the understanding that "India could wait for her Central Bank."

The example of other countries.

It is worthwhile to consider the decentralised banking system which presumably is the ideal in the minds of the critics of the Reserve Bank. Canada is not much the worse for the want of a Cental Bank and the thorough organisation of a money market. Although the recently appointed Macmillan Commission which investigated the banking system of Canada recommended the formation of a Central Bank, the Canadian Banks headed by Mr. J. Dodds have reiterated the usual objections to the formation of a Central Bank. "That the

[1] *Vide* the Annual General Meeting of the National Bank of India, held on April 3, 1928—Sir Charles MacLeod's speech.

Finance Department meets the needs of the Canadian banks, that a Central Bank would be needless expense, that it would weaken the existing banks which would have to supply capital and deposits free of interest," are the hackneyed objections.[2] It is also true that the Irish Free State Banking Commission presided over by H. P. Willis recommended the adoption of the system of banking obtaining in Canada. But for India it is clearly unwise to consider these examples as worthy of imitation. Conditions here are radically different. The Ministry of Finance in Canada, in the first place commands the full confidence of the public and the business circles. The Canadian banks have developed an extensive system of branch banking and enjoy an invaluable aid in their ready access to the money market of New York. But in India the Finance Department is suspect beyond words. The indigenous banking system is still in its infancy and branch development is unknown expect in so far as it has been attempted by the Imperial Bank. That the banking system of Ireland or Canada is still far from being a finished model completes the case against India trying to move on similar lines. Since these lines have been written the Canadian banking system itself has been overhauled on the Centralised banking plan.

We have therefore no alternative but again to put our hands to the formation of a Central Bank, the constitution and management of which will be suited to our own peculiar requirements. It is fortunate that, in spite of the highly disheartening fate of the last attempt our academicians are alive to the rich harvest of benefits which a Central Bank of Issue can confer on the industrial and economic well-being of the country.

The supporters of the Central Bank scheme consider that no time should be lost in the starting of a Central Bank as the pivot of the Indian money market satisfactorily adjusting credit and currency and bringing about an adjustment of the volume of credit to the volume of business needs of the country.

A Central Bank of Issue is necessary for the development of the banking resources of the country. It would furnish the means by which banks in need of large reserves can borrow from the Central

[2] See the London Bankers' Magazine, May, 1933, p. 728.

Bank and thus a national control over a sound and elastic credit and currency system can be secured through the C. B. of Issue which is wholly free from the influence of either domestic political pressure or powerful external factors interested in exporting our resources to their permanent benefit.

With its monopoly of note-issue it can act as the channel for the output and intake of legal tender currency. It would circulate a new kind of paper money which would soon constitute the bulk of legal tender money in circulation. The Government can be divested of the control over currency which can be controlled by this banking machinery.

Holding the Government treasury balances, currency reserves and the reserves of other banks deposited solely in its hands, it can pool together all the cash resources which now lie scattered far and wide. It can act as the agent through which the financial operations of the Government at home and abroad can be transacted.

As the sole and ultimate provider of the emergency currency which can be obtained by rediscounting approved bills or granting advances on approved promissory notes of the commercial banks, it can bring about the expansion and contraction of currency required to maintain stable monetary conditions. It would relieve the temporary pressure to which the small banks are generally liable and arrest the failure of those sound banking establishments which unfortunately fail to draw the difference between *immediate* and *ultimate* convertibility and commit the mistake of locking up funds in 'slow assets.' Currency famines would be prevented. Bank runs will not be the epidemic that they are. By its direction and regulation of the money market the Central Bank can renovate thoroughly the entire banking structure of the community. Under its supervisory influence the country's finances can develop freely without any hindrance from communal or party feelings, personal differences and political animosities. Its self-denying ordinance in the matter of dividends, its insistence on a high standard of banking, its efficient management of currency, and its detached eminence from the ordinary commercial banks of the country would enable it to regulate our national monetary and financial matters in the real interests of the country. Desirable changes in bank reserves, currency, cheque collections, Government finances, credit

policy, gold movements and the money market can be secured only through the instrumentality of a Central Bank of Issue.

The starting of a Central Bank would soon enable the country to realise that the bank rate and a wise discount policy can shower such inestimable advantages as credit expansion suitable both in point of time and degree, stable foreign exchanges, regulation of gold movements and maintenance of price-levels at a reasonable level of stability.

The inequality of interest rates in different parts of the country can be removed by loans made to each other by the branches of the Central Bank at the direction of the parent bank. An equitable flow of funds from one part of the country to another and from one industry to another, can be secured. It can act as the custodian of the national reserve with no selfish ends to preserve and administer the reserves in the wider public interests of the country.

Another advantage would be the disappearance of quotations of inland exchange rates and the premium of Bombay or Calcutta or Rangoon funds would disappear as soon as an efficient wire-transfer system as in the case of the Federal Reserve is adopted in this country. Under the leadership of the *Central Bank* a *national banking policy* would become possible. Free from all suspicions as the proverbial Caesar's wife was, or ought to have been it can introduce an exceptionally high degree of integrity into the financial life of the country and secure its real financial independence, sounder economic organisation and practice. At last the Government have succeeded in bringing out a Reserve Bank in a more or less acceptable form. Even the European interests have relaxed their former stiffer attitude and have promised to co-operate with the Reserve Bank.

The Organisation of the Central Bank.

Analysing the constitution of the important Central Banks of the world we find them to fall into three different classes. They are either (*a*) Pure shareholders' banks, (*b*) Pure state-owned banks, (*c*) Banks of mixed ownership. But in the last category there are several sub-divisions : (1) Where the state and the shareholders own the capital of the bank, (2) Where the state, the indigenous commercial banks, the foreign banks and the private individuals have the privilege

to own the shares of the central bank, (3) Where the capital is or can be owned by the state, the shareholders and the indigenous banks, (4) Where the capital is owned by international groups and state donation. All these can be considered as quasi-state banks. But there is another type which belongs to this classification of mixed ownership. All central banks which have their capital subscribed by the shareholders and the indigenous banks of the country alone and where the state is no shareholder must be considered as banks of mixed ownership. Which of the above types can India select ?

Pure shareholders'. Central Bank.	Pure state-owned Central Bank.	Mixed ownership.
The Austrian National Bank.	The Commonwealth Bank of Australia.	The National Bank of Czechoslovakia.
The National Bank of Belgium.	The National Bank of Bulgaria.	The National Bank, Copenhagen.
The Bank of England	The Bank of Esthonia [4]	The Bank of Mexico
The Bank of France	The Bank of Finland	The Central Bank of Chile.
The Reichsbank of Germany.	The Bank of Latvia	The Bank of the Republic of Columbia.
The National Bank of Hungary.	The Bank of Poland [5]	The Bank of Lithuania.[6]
The Bank of Italy	The State Bank of R S F S.R.	The Federal Reserve Banks of the U.S.A.[7]
The Bank of Japan [3]	The Swedish Riksbank	The Swiss National Bank.
The Nederlands Bank	... ...	The Bank of Greece.[8]
The Norgis Bank	... ...	The South Africa Reserve Bank.
The Bank of Spain	... ...	The Bank of Albania

3 The state can own half of the capital of the bank.

4 From 1929 the Government would endeavour to sell the shares to the public.

5 Shares worth 50 millions which were first subscribed by the state can later on be sold by it to the public.

6 The chief peculiarity is that Municipalities, Companies and Associations other than individuals can also become shareholders.

7 There has been no offer of stock to the public or the state as contemplated by the statute for this has not been done up till the present. In reality they are shareholders' banks but member banks alone can become shareholders. The state has no share in the capital of the bank. See Kisch, " Central Banks " also Memorandum on " Central Banks " issued by the League of Nations. See also Spalding, Dictionary of World's Currencies.

8 The state can hold shares worth 1/10 of the total capital amounting to 400 millions

While there is a large measure of agreement on the necessity of starting this new banking structure, there is however, a considerable difference of opinion as regards its constitution and management. One school regards the state-aided shareholders' bank as the best ideal. A privately-owned Central Bank managed by competent businessmen free from political pressure and governmental control is certainly best fitted to control credit and currency and in accordance with the needs and necessities of business. It is only a shareholders' bank that can hope to obtain emancipation from political pressure and secure independence from the interference of the Government executive in the day-to-day control of its business regarding its banking policy. Examples of other countries where shareholders' banks have worked successfully can be cited with confidence. It can also be emphasised that the state has earned a notoriety as a bad manufacturer, an indifferent financier and an indifferent merchant and would doubtless prove an incompetent banker. The state is too wooden and soulless to succeed in gauging accurately the monetary requirements of the business people. Hence the shareholders' bank which is governed by motives of self-interest would be efficiently and properly worked for the commercial interests. The knowledge and capacity of practical businessmen are sure to keep them to the right path. Banking is a species of trade in which the Government should not take part: for if it does, it would lead to an irresistible demand for a too liberal extension of discounts and loans during days of depression and inflation would easily become the watchword of every demagogue.

It must however be recognised that all the arguments are not in favour of the shareholders' bank. Firstly, anybody can become a shareholder and deal with technical matters such as credit and currency which can be handled by experienced men possessing talent, study skill and experience. We cannot expect any large number of shareholders to "give a single thought to the object for which the Central Bank is supposed to exist."

The shareholders' control over the directors is generally a myth and always ineffective, and so long as the usual dividends

drachmas. It is the intention to ultimately unload this share capital on the market and make it a pure shareholders' institution. See the London Economist, p. 608 (1926).

are forthcoming it is impossible to rouse any serious interest in internal affairs. A private shareholders' bank necessarily means hunting for profits and if the Central Bank of Issue is to perform its real duties, hankering after profits would defeat the wishes of the enthusiasts who aspire to make the Central Bank of Issue the controller of credit and currency mechanism of the country. This was the case with the South African Reserve Bank which had to perform additional functions in order to pay a dividend to the shareholders and cover a portion of the overhead charges. It was on this very ground that the recent Banking Commission of the Irish Free State also disapproved of the idea of the private shareholders' bank.[9] But some amount of conscious control can be devised to make the shareholders' bank alive to the national economic interests. All the privately-owned Central Banks of Issue, with the notable exception of the Bank of England and the reorganised Reichsbank of Germany, work more or less under a rigid system of control or supervision so that national interests in financial policy can be secured easily. In countries where established banking traditions exist and where trained bankers are available to run the Central Bank on sound and conservative lines, the control of the state would naturally be relaxed.

In case of the poor countries, however, it may be considered uneconomical and unwise to pay a high rate of dividend derivable from the use of the currency reserves to the private shareholders of the Central Bank, while capital can easily be borrowed for the State Bank at four or five per cent. But it must be borne in mind that just as the state ought to concern itself with adequate service and not the question of profit from its police department so also it ought to concern itself only with efficient and economical administration of banking operations in conformity with approved monetary theory. The possibility of making profits from the handling of the note-issue should not therefore be allowed to rule out on that account the desirability of the shareholders' bank. Arrangements can be made for the participation of the state in the profits but it is not prudent to start banking operations with any obsession of profiteering.

The next consideration is that in countries where indigenous capital is not sufficiently developed the starting of shareholders'

[9] See the Report of the Irish Free State Banking Commission.

private bank would inevitably lead to a bid for ascendency in the practical management of the banking and the financial system of the country between the foreign and the indigenous capitalists. It is always essential to eliminate foreign influence from the control of the Central Bank of Issue. It is also true that a privately-owned shareholders' bank generally fails to be sufficiently representative of the different interests in the country. But these are by no means conclusive arguments in favour of the state ownership of the Central Bank as practical provision for Government interference can go a long way towards mitigating the evil effects of private ownership. The composition of the C. Bank's direction can be so arranged as to eliminate the influence of the foreign capitalist. The reservation of the powers of nomination to the board of the Central Bank would rectify the second evil so that by means of nomination by the state men of wide experience representing the important economic interests can be placed on the board.

Though the disadvantages attendant on the shareholders' bank can be toned down by devising suitable remedial measures, such as the limitation of dividends to shareholders, the allotment of shares to small investors, scattered all over the country, the restriction of the voting power to "one man—one vote," the prevention of the right to vote by proxy, the prevention of the manipulation of the votes by big shareholders, the creating of non-transferable shares to prevent concentration of control, the appointing by Government of outside business experts to manage the institution, the making of the shareholders' body a purely consultative one, the proper defining and limitation of the functions of the open market operations of the Central Bank and the participation of the state in profits beyond a certain level, which are some of the methods usually followed, yet there are however some practical contingencies under which the privately-owned Central Bank loses its independence and its devotion to the public weal. The fact is that too much value should not be attached to the mere theoretical independence of the shareholders' bank. For much, too much, depends on the unwritten traditions and conventions of the institution and the exigencies of the financial situation in the state. Even a privately-owned Central Bank can be used as an engine of state policy. In times of pressure such as there were during the last war, private shareholders' banks have become purely Government

bankers and have relegated their chief duties of bankers' bank to a secondary position. These banks of issue would be made to discount treasury bills or grant advances to the state on interest-bearing state bonds. They can assist the Government indirectly by granting loans, advances at favourable rates to commercial banks on security of Government paper in various forms. Lending indirectly to banks to help the Government would make the credit of the Central Bank semi-automatically liquid. As banks secure surplus funds they would liquidate their indebtedness to the Central Bank while this desirable result would not be forthcoming if the Central Bank itself were to lend directly to the Government.

Even if the legal status of the Central Banks be so secured as to make it independent of Government control, it would have little effect upon the actual relations with the Government. Political influences cannot but tell ultimately on the privately-owned Central Banks. The divorce of business from politics cannot be pushed too far. The administration and policy of the Central Bank though conducted on the most scientific lines may sometimes have to be persuaded to see the Government's point of view.[10] Even the Bank of England is often subject to such pressure. But under normal circumstances lending by a private bank is far better as it would take the matter out of politics.

Again it is difficult to reconcile the idea of a privately-owned bank with the state-guarantee for the bank notes. This is the anomalous situation which the shareholders' plan of the Reserve Bank would have created and it is meaningless that the Government should give their guarantee without gaining an effective voice in the management of the bank. Perhaps a quasi-state partnership would be inevitable under such circumstances. However safeguarded the privileges may be according to the terms of the original charter concentration of shareholdings would soon be the prevailing feature and unless some sort of racial discrimination is made in the legislation, it would not be possible

[10] See H. P. Wills, "The Banker," October, 1927. Under political influence it seems that since 1921 up to the present time the Reserve system and the F. R. Board in particular has been under severe pressure to adjust interest rates so that the main objects of the F. R. System during the years in question has been the establishment of easy conditions for public financing rather than the restoration of sound liquid conditions in banking." See also Dr. T. E. Gregory. "The F. R. System of the U. S. A."—with an introduction by Walter Leaf.

to prevent aliens from becoming shareholders to a greater degree than can be considered safe. But when for any reason racial discrimination is not possible the shareholders' bank must be considered more or less wholly unsuitable.

State-owned Bank.

Ever since Prof. Keynes wrote his classic report in 1913, Indian opinion has been overwhelmingly in favour of the *State-owned Central Bank of Issue* which should on no score be mistaken for a *state-controlled Bank.* There is the prevailing opinion among the people that the special circumstances of India warrant the creation of a State Bank. The co-operative credit movement in India succeeded because of the state aid rendered effectively. If it had been left purely to unorganised self-help nothing so miraculous could have been achieved. In all matters of high finance the Indian people look to the Government to sponsor any new movement and the Government is always considered as the most potent factor in finance. In any sphere it would be difficult to divorce a system from the habits, customs and desires of the people who make use of it. Very great weight attaches to a bank founded upon the credit of the Government and its resources. It would go a long long way in implanting the banking habit in the minds of the people. Several people quote the instances of the *State-owned and state-controlled Central Banks* which exist in Australia, Bulgaria, Czechoslovakia, Esthonia, Sweden and Uruguay and argue that the State Bank can be started on suitable lines in this country. Even Ricardo advocated the creation of a State Bank in 1817 on the model of the Swedish Riksbank. He advocated a State Bank for England on the model of the Riksbank totally *independent of the ministers.* He says " the sinking fund is managed by commissioners responsible only to Parliament and the investment of the money entrusted to their charge proceeds with utmost regularity. What reason can there be to doubt that the issues of paper money might be regulated under similar arrangement." Except this positive pronouncement in favour of the State Bank no other arguments are given by him.

It is argued that the State Bank would give the quietus to the endless quarrels on the part of the Imperial Bank, the Exchange

Banks and indigenous banks for having the greater share in the capital of the bank. The characteristic fear of control by foreign capitalists would also be avoided by starting a State Bank without a substantial share capital. Such a bank would be sufficient for the present situation in India as there is no properly developed bill market for the present. A State Bank would draw the infructuous capital out of the pockets of the people in the shape of deposits. Even the quasi-state bank would do something in this direction and capital may be invested in the shares of the bank.[11]

One of the strongest points in the armoury of the supporters of the State Bank scheme is that the Government of India generally keeps on an average about Rs. 5 to 19 crores of loose balances every month in the hands of the Imperial Bank and that the Government are sustaining a dead loss on account of this management. The state can act as a Central Banker without any undue risk and with the unlimited means at its disposal earn sufficient resources to liquidate a portion of its debts or reduce taxation to the relief of trade and enterprise. The issue of money is a function of the Government and it ought not to be surrendered to any body of private individuals however well-informed and disinterested they might be.

Besides the above positive arguments some of the following negative arguments favour the conception of the State Bank ideal. A private Central Bank can easily become an annexe to the British commercial community which largely controls the Indian banking of the present day. The directors of a private bank would be responsible to nobody, while a sort of parliamentary control though it might prove to be a disadvantage at certain times can be exercised over a State-owned Bank. London high finance or the British commercial community has no confidence that the Indian Legislature would not select only men of the highest standing engaged in active business in India. If this thing is statutorily secured the problem of control over the State Bank would be solved. The main reason why the Indian people are

11 See the London Times (March 13), article on the State Bank for India—"There can be no question that a State Bank would have a most salutary effect in securing the confidence of the people with money to invest. India suffers from a vast amount of infructuous capital which a State Bank would be likely to draw forth in the shape of shares or deposits. Hitherto the investment of money by deposit n banks has been on a much smaller scale than it ought to be."

so strong and persistent on giving to the legislature the control of the Reserve Bank is this. The present-day Indian Executive is an *Imperium in Imperio.* It has full control over its loan policy and floats the loans at such rates and in such markets as it chooses.

The Indian Legislature has no control over this policy. People who are already aware of this limitation are keen on securing the control over the Central Bank. If the Executive is to be held responsible to the legislature, this insistence would neither be necessary nor demanded. Rightly or wrongly they have considered the management of the C. Bank a political issue. Although the underlying motive which ought to guide the framers of the banking structure should be based on economic considerations it has unavoidably taken on a political colour.

The Demerits of the State Bank.

A state-owned bank under state control is not, however, free from defects. When it is controlled by the state it tends to become a mere banking department of the Government. The situation would be something analogous to a state railway system or a state industrial monopoly. The pressure of political expediency may often prove irresistible and such business propositions as will not be undertaken by any ordinary bank would sometimes have to be entertained for more or less purely political reasons. The history of the Swedish State Bank (Riksbank) during the first part, say 1668-1835 illustrates how the bank became an element of intense political strife of the day. During the second period of the history (1834-1926) it succeeded admirably as a Central Bank and was kept independent of the Government of the day and at the same time without being under the control of private interests. This was due to three conventions adopted by the people. The Bank Commissioners were traditionally re-elected until they wished to withdraw thus securing continuity of policy. They maintained a certain proportion between the "technical" and the "political" commissioners. They preserved the institutional conservatism of the State Bank. Such measures can be adopted by this country if the State Bank conception alone is approved. In the case of the poor countries like India which are not economically developed but politically subject to foreigners the advantages flowing

out of a State Bank may well be expected to outweigh the evils thereof. With a different constitution, measures which are not to the interests of the financial creditors and political masters would ordinarily be neglected. It is for this reason that the State of Czechoslovakia has contributed to the share capital of the Anglo-International Bank formed in 1927. This bank is specially meant to finance the international trade of the country and further trade relations between Czechoslovakia and the United Kingdom. But in a State Bank we have to reckon with the danger of socialist aims and programmes creeping slowly into the sphere of national banking.

A State Bank can also be used for inflationary purposes by needy financiers who may be hard put to balance the budget. They can make encroachments on the State Bank's fund. The history of the Bank of Amsterdam which was organised as a State Bank is an illuminating instance in point.[12] It was illegally mismanaged by a committee of the Town Council. Money was lent for political purposes ; some of it for municipal money-lending schemes designed to help unemployment caused by the war and some to the Dutch East India Company which carried great political influence. The bank, as need not be added, had to wind up its affairs at the end of the war. Again it is also quite possible that public bodies might not be getting as much credit at the hands of the State Bank as they would at the hands of a shareholders' bank. There is keen competition in England amongst banks for securing the accounts of the quasi-Government bodies and if banking is nationalised they fear that they would receive less favoured treatment. It must also be realised that many experiments in the direction of State Bank have met with failure and the oft-quoted illustrations are the failures of the State Bank of Russia, Bulgaria and the first and the second banks of the U. S. A. There are some who quote exultingly the examples of the Dominion State Bank of the Australian Commonwealth which started without any basic capital of its own.[13] It is little remembered that their conditions are so vastly different from ours.

[12] See Walter Leaf, "Banking," p. 184.

[13] It was in July, 1927, that the Australian Commonwealth Bank began issuing weekly returns on the model of those of the Bank of England. Sir E. Harvey has not yet completed

The opinion of several competent economists goes to show that the State Banks lead to the confusion between public credit and private credit and "unless a dominating personality or a superman like Vichanagradsky or Count Witte commanding prestige in the world of finance as well as the State runs the State Bank, it is apt to be shipwrecked in times of bad weather." [14]

Another disadvantage of the State Bank is that it generally fails to weed out the weak and inefficient banks by refusing to rediscount their worthless paper. As a result of this spoon-feeding and nursing of the incompetent banks it fails to develop a ring of well-managed commercial banks acting in co-operation with it.

It is also stated that it may fail to train an adequate number of men who can be depended upon to run the banking institutions of the country in the future. This seems to be altogether an undeserving attack and if a bank working towards public welfare and not private gain can do nothing in this direction it is impossible to believe that it can be performed by any other banking institution of the country.

The science of economics, however has sufficiently advanced to enable us to establish a State Bank but yet its security from political influences may be guaranteed. A proper definition of its functions would safeguard it from experiments of socialism. The credit relations between the State Bank and the other banking institutions can be placed on a statutory basis. An adherence to well-laid rules, *both in letter as well as in spirit* would delimit its scope of interference with the working of the mechanism. By the compulsory training of apprentices and the promotion of banking knowledge and by founding an Institute of Bankers under its auspices, the State Bank can do something in the direction of training people in banking practice. But the most serious objection to the State Bank remains unanswered. The state

the task of approximating the Commonwealth Bank to the Central Banking type. It has been attempting to open a foreign branch in New York. This undertaking of foreign banking is not quite in keeping with the accepted practice of the C. R. Banking institutions (see the London Bankers' Magazine, September, 1927). Efforts are now being made to bring it into close touch with the Commercial banks and to bring it into line with the practice prevailing in other countries possessing a C. B. of Issue (see the London Times, article on Empire Banking, August 12, 1928, p. 135).

[14] See Sir J. C. Coyajee, "The Reserve Bank of India."

always protects itself against maturing liabilities by making even its future obligations payable on a fixed date, or after, at its own pleasure. If in addition to this huge indebtedness, it undertakes large demand liabilities on note issues and enormous demand liabilities on member bank reserves and other deposits that may be attracted. it would be a dangerous reversal of the existing policy outlined above. The responsibilities of the state would be very heavy and it is financial folly to saddle this Government credit with a heavy load. True financial wisdom consists in protecting the credit of the Government against all possible danger.

A Quasi-State Bank.

Students of Indian banking history might easily suggest that it would be the happiest solution of the present situation if the Central Bank were to have a part of its capital, say two-thirds, owned by the shareholders and the rest by the state. Such a thing existed in the early years of the history of the Presidency Banks of Bengal, Bombay and Madras. The control may be exerted by mercantile directors elected by the shareholders and the Government directors nominated by it ; two-thirds by the former and one-third by the latter. Government directors might have the right to veto the transactions considered prejudicial to the Government's financial policy or public interests. This proposal cannot be rejected incontinently. It is not fraught with disadvantages greater than, or greatly in excess of, the benefits derived. Great discrimination in selecting directors by the different interests would tend to inspire the people with confidence. The only grave defect of this scheme is that Government may fail to abstain from political interference or manipulations. Even a pure shareholders' bank is not exempt from such wilful, deliberate and inevitable interference on the part of the state. The main advantage of the quasi-state bank, is that it tends to make the bank " the people's bank " free from the domination of sectional interests or London financial interests and the vagaries of financial advisers of the Secretary of State. The representation of the state on the directorate of the quasi-state bank can be so made as to secure a vigilant watch over the national interests and prevent

the bank executive from subordinating Indian interests to those of any other countries. These are the objects which any sound Central Bank, constituted on whatever basis it might be, has to secure and it is immaterial whether it is a State Bank or a shareholders' bank or a quasi-state bank. Independently-minded people who have the courage to veto measures detrimental to Indian interests, must form the managing board and when this can be secured it is unwise to argue dogmatically or stand as sticklers for the principle of a state bank or shareholders' bank or a quasi-state bank.

Instead of recognising the merits and the demerits of each of the plans and coming to a satisfactory compromise which can be made workable each party strove to have its own way till finally amidst the welter of this chaos, the stockholders' scheme which promised to contain the essence of the above proposals was evolved. The conception of the stockholders' bank has to be thoroughly grasped before it can be realised how the best features of all the various schemes have been happily combined in the new proposal. A five per cent. India Bank stock is to be floated at par in Rs. 100 each or any multiples thereof but not exceeding Rs. 10,000. Thus in reality it is to be a state bank. The whole of the 5 crores of authorised capital is not to be issued but one crore is to be issued later as occasion demands to render unnecessary for the trustees and directors to buy up the qualifying amount of stock in the market. Each province having 1,000 stockholders will maintain a register of individual stockholders in the province and these will have the right to elect one director who must hold at least Rs. 1,000 of stock. Sixty persons are to be elected as the trustees of the stockholders of the province and each trustee has to hold Rs. 1,000 nominal value of the stock. Every member of the Council of State or the Legislative Assembly or the Legislative Council is to be an *ex-officio* trustee and it is these trustees that are to elect the directors. All the stockholders must be British subjects alone ordinarily resident in India. Besides the directors to be elected by the trustees of the shareholders of the different provinces thirteen others are to form the Board of Directors. One Governor and two Deputy Governors would be appointed by the Governor-General-in-Council. Two directors are to be elected from the Associated Chambers of Commerce. One director is to be elected by the provincial co-operative banks. The Govern-

ment can nominate four directors for three years in the first instance and thereafter for five years which is to be the period of tenure for the rest of the directors also.

It is not only true that many of the objections to the shareholders' bank or state bank can be successfully overcome in this scheme, but some of the following clear merits of the scheme can be successfully copied by the other countries which wish to construct a Central Bank of Issue. The regional basis of the directorate, the Indian predominance in the electoral college and consequently in the directorate, the limitation of votes and protection of small shareholders are some of the salient points of an essentially sound scheme which any central banking structure can be proud of. It has also the merit of allowing the legislators a chance to be elected to the directorate. This feature is undoubtedly a concession to the Indian public opinion and would not make the Central Bank "purely a political Bank" as the members of the Legislature have to resign on election to the Board of Directors. The Legislature is elected for political issues and there is no ostensible reason for its being approved as an electorate for the bank's purpose. Recent banking experience in Australia and South Africa shows us clearly that the retention of the Legislature as an electoral constituency easily lends itself to party nepotism. It is indeed a truism to assert that " the party whip should find no place in the bank's parlour and the directors' meeting should not be converted into a mere political dug-out." But this is given up in the stockholders' scheme. The Board of Directors would secure the independent element which not being recruited from the world of high finance would be free from the subservient tendency to vested interests. The Government nomination however secures the services of the people who are well-versed in public affairs, currency and finance. Conflict between domestic and external capitalists is avoided by giving preference to indigenous and Indian domiciled capitalists. It is true that the stockholders' scheme does not go far enough. But it is quite in keeping with the practice of some of the foreign countries where it is distinctly laid down that persons not belonging to the nationality of the country of the Central Bank cannot either hold shares or exercise a vote. Germany has recently enacted that the shares of the Reichsbank should not be held by outsiders. The regional directorate plan guarantees the representation

of all provinces and the fear of the much-dreaded influence of the Bombay speculators need not be entertained.

The necessity to pay the stockholders would undoubtedly tend to efficient management on the part of the Board of Directors. The co-operation of the Indian with the European businessman is also secured. The plan is largely Indian in character and Indian in outlook. Preferential treatment to the Imperial Bank in the allotment of shares is given up. The general interests of the inhabitants of the country who require stability of exchange as well as tolerable stability of internal prices are well-secured. Lastly, it is free from the undue control of the Government which can only nominate a few of the experts to the bank directorate to ensure business ability. So long as the financial administration is still in the hands of the irresponsible executive, even the starting of a state bank would be of little avail, for the bank executive, free from the influence of the mercantile directors, can manipulate the bank anyway it likes. Opportunity is given to the Associated Chambers of Commerce, the Federation of the Indian Chambers of Commerce, and the Provincial Co-operative Banks to elect directors. The introduction of the worst forms of racial and communal claims in the matter of election to the directorate is also negatived in this plan. Altogether the ideal of a non-official business institution independent of the legislature—Indian in domicile and Indian in character has been approached nearer in this scheme than any of the alternative plans.

By accepting this scheme, or any modified form of it with all its salient features, India would have the unique distinction and honour of holding forth a new model for the C. Banks of other countries have been based on a shareholders' basis or they are state banks or partly owned by the state banks and other banks such as the Swiss Bank where two-fifths of the capital is contributed by the cantons, two-fifths by the public and the remainder by the old banks of issue. The Central Bank of the country though based on a shareholders' basis, should possess at the same time " the quintessence of State Bank proposal " and if framed on a state-*cum*-shareholders' basis it should be so organised as to rob it of the chief demerits that are attendant on such plans. Most of the fundamental changes that have to be incorporated in any new plan should make concession to public

opinion as expressed in the Legislative Assembly and it is apparent that the opinions of London high finance and the British commercial community must also be placated. The removal of the elected members of the Legislature from the body of delegates elected by shareholders in each province for the matter of election as directors is undoubtedly due to the intervention on the part of the India Office and pressure on the part of the foreign commercial community. Although the Indian Legislature might consider itself justified in persisting in its demand for its representatives on the board and although it can successfully retort that the Government nominees on the directorate can equally be considered as representatives of political influence, still in order to secure the co-operation of the London financial interests this essential point has to be sacrificed.[15] Without a spirit of reasonable compromise and hearty give-and-take in this vital issue it would be impossible to manage the Reserve Bank successfully. Both the London financial interests and the Indian public have to modify their opinion and co-operate with each other. So long as the financial control rests in the hands of the Secretary of State and so long as the policy of non-intervention is not pursued by the India Office in Indian affairs no real measure of autonomy can be enjoyed by the Government of India even though it would be in substantial agreement with the Legislature.

The working model of the Central Bank.

In deciding the working policy of the Central Bank there are precedents of other systems which would have to be taken into consideration. It must be examined how far they may or may not prove applicable to this country. A recent writer [16] in the Mysore Economic Journal has classified the different Central Banks into three characteristic types, taking the method of operation as the basis of

[15] I am personally of opinion that the retention of the electoral college and enrolling Legislative Councillors as *ex-officio* members is a wise thing, for few men of business initiative, acumen and experience can be found outside this list. Even if they exist they would be so much engrossed with their own business that they would not care for the official honour. If after election they were to retire from the Legislstive Assembly or Council there would be no real grievance and the London authorities ought to concede this.

[16] See the Mysore Economic Journal, May, 1927.

classification. There is firstly the instance of the Central Banks which act as the pure bankers' banks which, generally speaking, have nothing to do with the public but only confine their operations to the Government and the members of the banking structure. Secondly, there is the mixed central banking such as done by the prominent European Central Banks like the Bank of France and the Reichsbank of Germany. Finally, there is the unique example of the Bank of England which always remains out of the periphery of the money market and intervenes on critical occasions to save the other banks and members of the money market from the ruin of impending collapse of credit. This classification apparently is unscientific. Central Banks of Issue can act as bankers' bank without having anything to do with the general public. They can grant credit only in the shape of re-discounts. The Federal Reserve Banks of America, the Reserve Bank of Peru and the South African Reserve Bank, the latter two of which are modelled purely on the first, are bankers' banks. This is generally referred to as the American type of the Central Bank. Central Banks can act as commercial banks, and the loans and advances to others than the Government might form a major portion of their earning assets. The Banks of Issue of Canada, Brazil, Latvia, Esthonia, Australia, Russia and Greece, Uruguay and Egypt operate mainly as ordinary commercial banks. These are usually referred to as banks of issue modelled on the continental type. The Bank of England discounts for the general public at the market rate at all its branches. It attracts deposits from the general public although it pays no rate of interest.

Generally speaking, the constitutional framework of the bank itself and the work by it determine the method of its operations. A State Bank owned wholly or partly by the state and freed from the necessity to earn profits can pursue pure central banking business or remain as a reserve or emergency bank meant solely to correct the mistakes of the other banks. The physical point of contact between the man in the street and this kind of Central Bank consists in the former's handling of the Central Bank's note. A shareholders' bank would be forced to undertake mixed central banking in order to earn certain minimum rate of dividend for the share capital and thus reduce the overhead charges. It is indeed true that even an emergency bank

would have to undertake open market operations[17] of a definite type so as to be able to control the credit situation as soon as it is considered desirable to do so. Without limited open market operations no Reserve Bank can hope to control the credit situation. If the Reserve Bank fails to lend to the money market the withdrawing of which amount would tighten credit there would be no scientific credit control.[18] Again if the private banks were to develop monopolistic tendencies and attempt to hold the community to ransom there should be the reserve power to enable the Central Bank to compete with the private banks.

Although it is true that if the maximum rate of dividend which the shareholders of the Central Bank of Issue can secure, is fixed in the charter of incorporation, it can undertake to act as a pure Central Bank confining its business solely to scheduled bankers still the necessity of limiting competition on the part of the state-aided Central Bank with the ordinary joint-stock banks of the country has to be borne in mind. Even if the Central Banks conduct limited open market operations they ought to eschew unfair and aggressive competition with the different banking institutions which have individually

[17] There are two definite meanings attached to this word. In the wider sense it refers to all transactions of the Central Banks, *i.e.*, purchases of bills from individual concerns besides their loans. In the narrower sense it signifies the sale and purchase of Government securities by the Central Banks on their own initiative in order to realise their own credit policy. A mere raising of the discount rate may be ineffective. At such times the sale of securities would absorb the available surplus and the "mopping" up of available funds takes place. Similarly, when the collection of taxes means the return of large funds from the money market the stringency can be reduced by purchase of securities by the Central Bank in the market. In this country the purchase of sterling can act as a safety valve in reducing stringent situations in the money market. Thus the open market operations necessarily supplement and enforce the Central Bank's discount policy.

[18] We find this situation illustrated clearly in the Japanese banking situation. The Imperial Bank of Japan's permanent contribution to the available supply of banking capital is far from great. As the amount of its loans to the ordinary banks and to individuals during normal financial periods has been very small it is unable to control credit. As Allen says, "this *is a weakness in a Central Bank* for it is obvious that if such a bank is in the habit of making large loans to the outside market in ordinary times it has the power to control the creation of credit during periods of excited trade because it can then restrict its loans and so check speculation. This at any rate has been the policy of Central Banks in other countries." See G. C. Allen, "Modern Japan and its Problems," pp. 156-58 (Italics mine).

and collectively done much service for the benefit, prosperity and financial stability of the country. Unless this advice is heeded the attempt of the Central Bank to control credit would be misunderstood. This is what has taken place actually in the F. R. Banking system of America during the formative period of its existence. The member banks who were feeling the stress of competition accused the F. R. Banks of forcing money into the market which had no real need for it; of keeping the rate, *i.e.*, the rediscount rate below the open market rate and so tempting the member banks to borrow and re-lend profitably, generating a prolonged stock-market boom and bringing about a situation that is not conducive to safety." So the agitation there was to limit the open market operations. It is this ideal of pure central banking with *very limited open market operations* that has to be selected as the suitable model for our Reserve Bank. Possessing a few offices which can be opened at Calcutta, Bombay, Madras, Rangoon, Cawnpore, Lahore, Delhi and London, the Central Bank of Issue whether organised as a State Bank or as a shareholders' one cannot hope to conduct mixed Central Banking. Besides, it would be unfair and impolitic to encroach upon and interfere with the business of the existing banks. If deposits are attracted from the businessmen these naturally expect the Central Bank to make advances and look after their business needs. This makes the Central Banker undertake commercial banking operations on a large scale and keen competitive conditions would ensue.

The ideal of the Bank of France as "the initiator of banking facilities" through more than 600 branches is placed before the public for due consideration and as this development of branches can be undertaken in this country by State-aided banks alone it is considered imperative that we should copy the example of this useful institution. Such has been the opinion in banking circles since the time of Hambro's minute in the Fowler Report of 1899. This is advocated afresh by Sir Purushottamdas Thakurdas in the Minority Report to the Hilton-Young Commission.

Circumstances seem to favour this idea, for the ideal of the Bank of England, the *grande dame* among C. R. Banks which like Aristotle's God lives enthroned in magnificent isolation content to interfere occasionally, is eminently unsuitable to our country, for the indigeneous banks are few and their working capital is small and

the banking habit is undeveloped. Hence the useful privilege of re-discounting by means of which the ordinary banks can increase their working capital tenfold cannot and ought not to be sacrificed. But if continuous borrowing even for capital uses instead of temporary and emergency purposes is to be the object of rediscounting it has to be strongly condemned. In England the Big Five possess a large working capital which is several times greater than that of the Bank of England itself. So they are not enamoured of this privilege. Besides the practice of the English businessmen is to view this rediscounting with ill-concealed contempt. They have an innate dislike for their bills being "peddled" about in the market from door to door. They use bills as security for advances instead of selling them to the Central Bank.

The ideal of the Central Bank in our country should be on the other hand to operate continuously on a limited scale and always in a manner to interfere as little as possible with the privileges of the existing banks but yet secure the wider interests of the whole country. But the opening of the branches in areas already covered by the existing banks would lead to competition with them and the Central Bank is not to be a competitor with the existing banking institutions. Again, the opening of branches in numerous places would lead to the scattering of the cash reserve. The real object of the Central Bank is to " accumulate a great central monetary pool " which has to be fed by diverse streams running into it. Resolute monetary control can be achieved by the custodian of the huge central stock and commercial operations should not be undertaken by the C. B. of Issue and any first-hand relations except those that fall under the category of open market operations between the C. Bank and the trader are to be tabooed. Even if non-interest-bearing deposits alone can be attracted by it, it would still be forced to conduct operations of a commercial banking character which can be performed equally successfully by the ordinary joint-stock banks. It would not be free to pursue unhampered its particular credit policy nor would its funds be highly liquid if loans are made directly to industrialists and businessmen also who are the customers of the C. Bank.[19]

19 See Sir C. H. Kisch, "Central Banks," p. 105.

The work of the C. Bank of Issue.

Granted that this independent authority based on a stockholders' plan, free from political influence or that of the exploitation of sectional or party interests is created, it behoves us to study the actual work it would have to perform in the banking system of this country. Issuing notes or paper currency, watching the gold reserve of the country, controlling and regulating credit in the money market so as to satisfy the currency requirements according to the ebb and flow of trade and acting as the Government banker, keeping its accounts, floating loans and remitting funds on its behalf to satisfy its disbursements, are some of the functions that the new institution will be entrusted with.

Note Issue.

The Central Bank's sole object in issuing fiduciary currency is to confer all the well-known advantages of paper currency such as the economy of gold and its elasticity to suit the legitimate needs of trade and commerce. These objects are to be secured without at the same time subjecting the community either to the evils of artificial expansion, rising prices and speculation or the evil or artificial contraction, falling prices and depression on the other side.

The transfer of the assets of the Government of India to the Issue Department of the Central Bank would have to be made as soon as the Central Bank would be in a position to issue its own notes. Lest the popularity of the notes might be endangered, they would have to be double guaranteed, firstly by the Bank and secondly by the Government of India. If the antiquated machinery of a bi-departmental system [20] is selected as the model for the Central Bank the notes of the Issue Department would have to be handed over to the Banking Department only in exchange for other notes of the Bank or the Government of India notes, for gold coin and bullion or gold securities or rupee coin or Government of India securities or

[20] The real danger of this system is the immobilising of the gold in the Issue Department and the real gold available to external demands would be held by the Banking Department and the whole of the pressure would be felt by the small and highly sensitive portion of the gold stationed in the Banking Department. A more effective credit policy can be pursued only by a combination of the two departments which would tend to make the reserve ratio less variable than before.

such bankable bills of exchange which are permissible as securities for the issue of the bank's notes. Each department of the bank would be liable for its own obligations. So far as the Reserve that has to be kept by the Issue Department of the C. Bank against notes is concerned, the suitability of the proportional reserve system or the fixed fiduciary system has to be considered. Since the Hilton-Young Commission's Report recommended the proportional reserve system and suggested that forty per cent. gold and gold securities have to be kept against these liabilities, those who are bent on opposition for opposition's sake have already raised the cry that the fixed fiduciary system and the backing of the extra notes by metallic reserve is preferable to the proportional reserve system. Here again, as in the case of the organisation of the Central Bank, there is nothing but futile war of words. The fixed fiduciary system can be made suitable even for agricultural countries requiring seasonal expansion of currency.[21] In as much as the economy of gold is the main criterion, the note issue has to be modelled on the proportional reserve system with proper safeguards to curb the easy expansion of notes, for every note issued against gold means an actual loss. It would be great inconvenience to the public to take bullion to the bank and get notes in exchange ; because the latter are so much easier to handle but the Bank has to take the trouble and expense of printing the note and guarding the gold without any compensation for the same. The proportional reserve system has already been accepted definitely by this country and embodied in the Paper Currency Amendment Act of 1923 (Section 18). It would certainly seem illogical to recommend the scrapping of this accepted feature [22] The majority of the Indian people require however a fifty per cent. of gold coin and bullion reserve against the liabilities of the Issue Department of the Bank. This is the exact proportion of metal already recommended by the Paper Currency Act. Although the Government guarantee

[21] See the Economic Journal—September, 1928, for the English Bank Note Act.

[22] The only theoretically approved plan or checking inflation of note-issue is not to confer on them the legal tender privilege. As in the F. R. Banking system the bank note may not be endowed with legal tender privilege and this would make arrangements for its prompt withdrawal. The state can receive them in payment of public dues but they must not be made legal tender for private debts. For other methods see my paper " Some Foreign Banking Systems and their Lessons, the Indian Journal of Economics, 1930, January.

means [23] that bank notes can embrace all the assets of the State ; the keeping of a lower metallic gold proportion than this accepted one would give scope for misunderstanding. Whatever might be the proportion accepted for the present it is idle to attach any sacredness to the ratio of the reserve. It is the general revenues of the State that form the backing of the note-issue. As the upholders of the Banking School point out no fixed minimum cash reserve is necessary. Mere convertibility of paper into gold and *vice-versa* is a sufficient safeguard. But the real danger lies in the draining away of the reserve and although it is true that if sound banking exists no other quantitative restrictions need be imposed, yet in practice all countries have adopted this feature. In theory at least they are guided by the currency principle, though their actual practice may conform more to the banking principle.

Whatever might be the proportion of the metallic reserve of the note-issue the method of note-issue must be related to trade activity by permitting the Central Bank to issue notes against the security of bills of exchange. Issuing fiduciary currency against short-dated bills of exchange representing trade, industrial and agricultural activity is a sound principle adopted by almost all important countries. The circulation of such notes would confer the needed elasticity and in any other conceivable emergency [24] notes can be issued on the payment of taxation, even

23 The mere technicality of Government guarantee is to secure their ready acceptance by the people. The real backing is gold and commercial paper.

24 Elasticity of note-issue is needed during seasonal, seculara nd cyclical changes. Secular elasticity means power to expand so as to satisfy the needs of trade in long-term periods without destroying the value of money. No currency is elastic enough to prevent long-period fluctuations of prices. This is mainly due to rigid requirements of reserve ratios. Seasonal elasticity can be secured easily and American, Canadian and German note-issues present successful examples of seasonal elasticity. Cyclical elasticity of note-issue in times of crisis is also essential to allay the anxiety of the public. England provided this chiefly by the suspension of the Bank Charter Act. France generally raised the maximum issue, Germany and U. S. A. secured it by the method of levying a graduated tax on the temporary deficit of gold reserve in their Central Bank. In 1928 England made provisions for emergency expansion with the consent of the Treasury. Some writers consider that even such abnormal emergency as a war has to be considered in the matter of note-issue regulations.

But powerful control over the note-issue by the discount rate, open market operations and moral persuasion is essential to satisfy the needs as the case may be. Until this is secured there can be no automatic elasticity of note-issue. An adequate self-regulated note-issue is a misnomer and except for seasonal needs there can be no such thing as cyclical and secular changes in note-issue without discounting the price level.

after the minimum legal cash reserve requirements have been touched. This process of extracting seasonal emergency would be less painful and more easy than at present (*i.e.*, pre-Reserve Bank days) when currency expansion could be secured sometimes unwillingly by the Imperial Bank pledging hundies in the hands of the Controller of Currency. This type of elasticity was not only limited in volume to 12 crores but could only be obtained by paying a stiff price. While in the past and the present we have erred and have still been erring in the direction of too rigid and inelastic note-issue, in the future we might swerve to the opposite direction. So too many avenues should not be thrown open to secure the needed elasticity of fiduciary currency.[25]

"If public satisfaction is a great asset in currency matters" as the Chamberlain Commission has pointed out the keeping of a fifty per cent. metallic reserve against the note obligations would be essential. It would maintain the *status quo* recommended by the permanent provisions of the existing Paper Currency Act. Although a half and half security and metal basis is recommended for the note-issue still it is a mistake to suppose that a huge gold reserve is needed as support to the note circulation. After all the gold reserve of the C. Bank is only a regulator fund. The volume of circulating media required in the country need not be based on this reservoir. Although the *raison' d'étre* of a reserve is to meet all demands and make the gold stock *an active reserve instead of a lifeless hoard*, still in reality gold withdrawal would be taking place for export purposes only. Very little use of the gold reserve even for exchange purposes need be made if only there is stability or uniformity in the movement of comparative price-levels. It is this that determines the exchange rates and not the size of the reserve lying in the hands of the Central Bank.

The banking department of the C. B. of Issue must also be forced to maintain a like deposit of 40 to 50 per cent. of gold or gold securities

[25] Even Prof. A. O. Pigou who is no staunch supporter of the doctrine that the trade cycle is a monetary phenomenon points out the disadvantage or the easy elasticity of the proportional system of note-issue. It would easily lead to intensification of the boom in trade matters and the facility with which currency can be supplied is an important factor in the amplitude of business cycles. See "Industrial Fluctuations ;" see also the Report of 1918 Committee on Currency and Foreign Exchange in the United Kingdom.

against the deposit obligations it undertakes. Without such a reserve aiding the issue department of the C. Bank the reserves of the latter might be unable to bear the strain when notes are changed into gold at very short notice. It is the Bank of England alone which maintains a reserve against its note liabilities and gives full liberty to the banking department. Both the recently organised Reichsbank and the Federal Reserve Banks are bound to maintain a specific reserve against the deposit liabilities. The recently organised Bank of Poland contemplates a similar or like reserve of forty per cent. as against its deposit liabilities. In 1928 France adopted the minimum proportion of 35 per cent. gold backing for notes and deposits combined.

This is what has to be done even if the old-fashioned division of the C. Bank of Issue into two separate banks is adopted. It would be far better to discard this antiquated ideal and modernise our monetary machinery by combining the two banks into one department of the C. B. of Issue furnishing the public with a simple consolidated statement of its accounts. The superiority of this system has to be recognised. As the total gold held by the C. Bank can be easily placed at the disposal of the public, the certainty of pursuing a uniform credit policy always uninfluenced by the actual gold movement would be rendered possible. As the general interests of the country can be looked after in a more assuring manner, there should be a departure from the recommendations of the Hilton-Young Commission in this respect.

Deposits.

Another of my petty quarrels about the Reserve Bank operations is this. The C. B. of Issue should not be allowed to keep non-interest-bearing deposit accounts and current accounts of the traders and individuals. We have already seen some of the reasons why deposits should not be attracted. As the Indian public place implicit faith in Government institutions there is the possibility of the Central Bank completely commanding the money market.

The Government of India should appoint this Central Bank as the sole custodian of its cash balances and it is high time to recognise that the maintaining of a separate Treasury system, even in a modified form, is unnecessary. Many of the sub-treasuries are " mostly revenue-

collecting centres" as Sir B. N. Mitra puts it.[26] Reliable and trustworthy agents can be appointed to do this task of collection on behalf of the C. B. of Issue. No danger need arise out of this step if it is declared unlawful on the part of the depositary or agent bank to loan out the public deposits. The joint-stock bank, indigeneous or foreign, doing business in the country should be made to keep compulsorily a portion of their reserve (*i.e.*, 5% and 2%) against their current or demand and time liabilities respectively. The banks need not feel sore at the cutting down of their reserve to this extent. As the rediscounting privilege is being thrown open to them there would be no specific grievance except that free and willing co-operation of these injured banks would not be voluntarily secured. The smooth and easy control of credit requires their hearty co-operation and so long as they are dissatisfied there can be no hearty co-operation on their part. At least permission might be granted that half of the compulsory deposit might be made in the form of short-term Government securities. The loss of this portion of their cash reserve through its transference to the Central Bank might occasion certain inconvenience but the greater security afforded them through the existence of a Central Bank more than offsets it. These are the minor costs to which they would be subject for securing major improvements in the credit situation.

Cash Reserve.

With reference to the composition of the cash reserve some discretion should be afforded to the Central Bank specially in the formative period of its existence. While it can be insisted upon that during the march of a ten-year period a certain definite proportion of the metallic reserve is to be in gold, in the intervening period the Bank executive can be given a free hand in this matter. It would of course have to pay heed to public opinion and respect its sentiments by keeping its assets in liquid gold. But it should have wide discretion in regard to the amount of securities which can be readily turned into gold without any loss. But it should not be carried away by the short-sighted profit and loss philosophy. The purpose of the bank's cash reserve is to

[26] *Vide* his Oral Evidence before the Chamberlain Commission.

enable the Central Bank to convert the bank's currency [27] into gold or standard money and if this duty is faithfully discharged it repays itself in many thousand ways, the chief of which would be the inspiring of confidence in the minds of the people. The greater the liquid gold [28] in the reserve, the sooner will be the time when India can be placed on a real gold standard basis and some gold coin indication, not necessarily for extensive circulation can be minted. [29] Without such a physical embodiment of the standard "gold rupee" it is not possible to convince the metallists of the existence of the gold standard and that currency regulation would in future be with reference to this gold standard.

Nextly, the ultimate right to sell gold for delivery at foreign centres must never be lost sight of. The key to the whole situation is this. On one side there is to be the C. B. of Issue, with complete convertibility of its note-issue. On the other there are the deep-rooted habits of the people to encourage accumulation of precious metals. Gold is used as a savings fund. Unless the convention and habits of the people change there is a grave peril to the gold reserve of the Central Bank. The Bank management would have to be cautious in permitting the free use of the gold bars for all purposes, monetary as well as industrial. While these precautionary measures are justifiable the real gold backing of the Bank currency which is the only thing understood by a layman should be steadily increased.

There might be certain occasions which would give rise to an external drain of gold. At such times the active gold premium policy may be judiciously pursued. [30] Gold bullion has to be bought

[27] It is the British doctrine of gold reserve that has to be copied. A reserve is meant to be used in times of emergencies. The continental doctrine holds that gold reserves are to be accumulated, advertised and admired. It is indeed strange that the U. S. A. pursued this policy and checked the payment of gold in redemption of F. R. Notes during the period of the recent war. See A. P. Hepburn, "A History of Currency in the United Kingdom."

[28] It was decided to have 10 lakhs reserved from the annual surplus for the purchase of gold to maintain the gold-bullion standard with a certain amount of assurance. See India in 1926-27.

[29] This actual procedure was adopted by the French Government when the gold bullion standard was adopted in 1928.

[30] It has its own attendant disadvantages for it tends to encourage the importers of specie as against importers of other commodities. It also tends to lower the gold import point at the expense of the C. R. Bank which pursues this policy. Thirdly, if gold arrives before the maturity of loan it tends to depress the rate of interest in the money market and would defeat the object of the C. Bank if it attempts to tighten the market rate at that time

by the C. B. of Issue at Rs. 21-3-1 per tola and if the import of gold is to be stimulated it can, like the Bank of England, pursue the policy of buying gold at a slightly higher price per tola of gold.[31] Foreign gold coins can be purchased at a stated price or tariff and the price can be altered whenever the Bank wishes to encourage the importation of specie.[32] Both the Bank of England and the Bank of France pursue this system to encourage the free flow of gold into the country. Again the practice of interest-free loans on large gold imports can be pursued with the sole object of increasing the import of gold.[33] Even the Bank of England pursues a similar policy in allowing the importer of gold bullion the use of money against securities free of interest for 10 to 14 days with the undertaking to pay in gold.[34] Similarly there would arise occasions when the import of gold has to be checked by the C. B. of Issue. At such times the import of gold has to be repelled so as to check gold inflation and the following recognised methods in this direction have to be followed. The Central Bank can deter the free inflow of gold shipments. When exchange is favourable and the gold import point has been reached the C. Bank of the country can purchase the exchanges of the other country and thus prevent the possibility of any profit on the movement of gold as a pure exchange transaction. The Central Bank can lower the discount rate and gold inflow can be stemmed by this procedure. The C. Bank can pursue delaying tactics and prolong the necessary formalities in assaying gold and cause the profit arising out of this transaction on gold shipments to practically disappear. It may even inflict a loss by pursuing this procedure. This is what the F. R. Banks were doing during the autumn of 1928 when the prolonged boom on the Stock exchange could not be curbed by raising the rediscount rate. In spite of deterrent rates the F. R. Banks could not secure a tight hold on the wild gambling tendencies on the N. Y. Stock Exchange transactions and any import of gold from the English consumers into the American Banking system

[31] See the German Bank Inquiry Commission of 1908, p. 324.

[32] See A. C. Whitacker, "The Foreign Exchange," pp. 514-15.

[33] See Interviews on Banking and Currency Systems of England, Scotland, France, Germany, Switzerland and Italy, N. Monetary Commission, pp. 28, 214, 357.

[34] See the Hansard, p. 415; *ibid*, quoted from the "Foreign Exchange."

would have deprived them of the very little power they were wielding over the money market. Thus it is the acknowledged duty of Central Banks to take precautionary measures so as not to complicate the domestic situation by allowing the free inflow of gold into the money market and tending to aggravate the speculative tendencies further.

Other countries will certainly set up the cry "that India is beginning to make a scramble for gold." They will look askance at the very reduction of the minimum quantity of bullion from the Hilton-Young Commission's high figure to that of 40 tolas fixed by the Currency Act of 1927. But it must be remembered that even Recardo in whom originated the idea of the gold bullion standard, never set up such a high figure as 400 oz. for the United Kingdom.[35] If the Central Bank is free to pursue the well-known measures to attract gold so as to strengthen the gold holding of the country, the other countries should not misunderstand this action as calculated to drain away the world's supply. It is the bounden duty of our Central Bank to co-operate wholeheartedly with the other Central Banks for the purpose of securing the greatest possible economy of gold. International banking co-operation has become the order of the day and during the course of the last two years the elasticity and efficiency of international finance increased to a remarkable extent. Our Central Bank must move with the times and float on the current of international banking co-operation or be left behind.[36]

Another reason why a high proportion of gold securities has to be kept by the C. Bank of issue in the initial stages is that good commercial bills are scarce in this country and hence full freedom should be granted to the Bank Executive in this country. As pointed out elsewhere it would be keeping in conformity with the existing practice of all C. Banks of Issue created after the recent War. Interest-bearing foreign exchange is preferred by them to the holding of actual gold.[37]

35 His suggestion was for gold bars of 60 ounces only.

36 See my lecture on "International Central Banking Co-operation" delivered under the auspices of the International Fellowship Society at Cocanada, September, 1930.

37 This tendency has unfortunately received a check since England abandoned the Gold Standard.

Although it is easy to decry this tendency [38] for stipulating a high proportion of liquid gold as displaying the old mercantilist tendencies in these enlightened modern days, we think it would be essential to keep this high proportion of liquid gold in order to satisfy the layman who requires a solid and visible backing for the currency he uses. He would certainly misunderstand any large holding of silver in the reserve of the Central Bank. He would consider the standard to be still the "independent silver rupee standard." If the gold bullion standard means any real change from the old monetary standard the silver assets would be an encumbrance. They would be of assistance to the bank only so long as there is demand for the silver rupee. Increased amount of silver Rupee coins should not be held. We must decry the attempt to dominate the new-bank-note issue in terms of increasing quantity of rupees beyond the one recommended by the Hilton-Young Commission. This attempt is nothing but an unwise perpetuation of the state of "dyarchy" existing in our currency organisation. All this has arisen on account of the Hilton-Young Commission's recommendations. This attempt is nothing but failure to keep the old paper currency issue issued by the Government and the new bank-note issue logically separate. As has been suggested a separate provision of cash reserve for encashment purposes for the Government notes and for bank notes would have been more logical. Although it is in the interest of India to proceed slowly in the matter of demonetisation of the silver rupee still an increased holding of the rupee stock would not give much confidence. After all the banks' liability is to pay in gold bullion and not in silver so the rupee stock need not be maintained on a large scale. Why then keep more rupees in the reserve for notes expressed in terms of gold ? The liability for the redemption of the rupee is indefinite and would grow less with the time and the people would be forced to circulate it to satisfy their commercial needs. Any undue increase in the holding of silver rupees on the ground of excessive holding of silver rupees in the present-day composition of the P. C. Reserve will perpetuate for a very long

[38] See the paper on the "Future of the Gold Exchange Standard by Dr. F. Mlynarski—Papers published by the Gold Delegation Committee,

period our bondage to silver.[39] What is required is that people should be inured to the use of bank notes and curtail their dependence on silver as early as possible. When the psychological moment arrives it can then be declared no longer legal tender. Demonetisation has to be affected as soon as circumstances are propitious. It is quite possible that the new bank will be confronted with large and increasing quantities of rupees issuing out of hoards as the people begin to realise that it is the consistent policy of the C. Bank to popularise the Bank note. Surplus rupees would have to be returned to the Government who would have to convert them into gold securities out of assets obtained from the sale of silver or by borrowing for this purpose.

The holding of the Government of India Rupee Securities in the reserve as it is now done in the P. C. Reserve has to be continued though to a limited extent and a margin must be left for the holding of legitimate commercial bills. The prime object is to leave the Bank the greatest possible freedom from mechanical restrictions in pursuing its reserve policy. Otherwise the rigid adherence to laws regulating the composition of the reserve would curtail the independence of the Bank Executive and as they have to manage a bewildering stock of gold, domestic and foreign bills of exchange, silver rupees, rupee securities (a relic of the old regime) and gold securities against the note-issues, any attempt to fix rigid restrictions as regards their respective amounts would be futile and the Bank Executive would only be pursuing a will-o'-the-wisp. One fails to see what the real benefit would be in suggesting the incorporating of rigid restrictions in the respective holdings of the metallic reserve which can only be realised after a lapse of 10 or 20 years.

The Rate of Discount.

This is the chief means at the disposal of the Central Bank of Issue which enables it to maintain the due proportion between the gold holdings, the note-issue and the volume of credit. The

[39] For the terms of the Silver Redemption Fund see the next chapter on the "Reserve Bank.".

administration of the discount rate policy of the Central Bank should be, broadly speaking, on lines similar to those adopted by other gold standard countries. Domestic inflationary and speculative tendencies, the volume of credit, the movement of prices, the level of foreign exchanges, the condition of domestic economic conditions and changes in international business conditions must influence the decision of the Board of Directorate of the Central Bank in fixing the bank rate. The percentage of cash reserve or gold holding alone should not be the sole determinant of the bank rate.

There are two illustrious examples before us and the suitability of the first or the second method in fixing the bank rate would have to be discussed in detail. Normally speaking in England the bank rate is above the market rate of interest on similar types of commercial paper. In the U. S. A. the discount rate does not follow the above rules but it ranges between the open market rates for ninety days banker's acceptances and 4 to 6 months commercial paper. As Burgess puts it " the discount rate moves within a ribbon whose borders are the commercial paper rate and the open market rate for bills."[40] Although the two countries charge the discount rate on quite different principles " the cost of obtaining reserve funds is relatively the same and not far distant." This has been due to the fact that "a fair price is charged for the reserve funds."

Which of the two precedents can be of use to our Reserve Bank? Have we to discard both these precedents on account of our very different banking organisation? The *Bank rate* which the Imperial Bank charges is the rate on advances against Government securities. The Imperial Bank *Hundi rate* is the price charged for discounting hundies and the bazar rate for hundies is sometimes lower and sometimes higher than the Imperial Bank Hundi rate. When necessary the indigenous bankers or shroffs sell the hundies to the Joint-stock banks or the Imperial Bank. The ordinary joint-stock banks usually charge a higher rate than the bank rate for advances. As this situation is different from that obtaining in England or America the suitability of their bank rate policy has to be discussed in detail.

In the Indian money market there are no bill markets. The market here means rates on customers' loans made under cash credit

[40] See W. R. Burgess, " The Reserve Banks and the Money Market," p. 191.

system. The rates for such loans are not strictly highly competitive but are known to the Imperial Bank and they may be uniform in the important national money markets. It is these customers' loans that would have to be rediscounted with the Central Bank of Issue until bill acceptance and an open discount market is developed. This rediscount rate for loans ought to be different and higher than rediscount rates for hundies and few bank acceptances that might be created. In each of those cases the rediscount rate should be higher than the market for that particular type. Until a bill market is developed and bills are held in the portfolio of the banks as their secondary reserve the rediscount rate for acceptances will not become all important.

When these are to be had in sufficient quantity the rediscount rate can be kept far below the rediscount rate for loans or advances on Government paper or commercial paper based on the cash credit system. *In all these cases of rediscounting the Central Bank's policy should not be to make money artificially low or artificially high. In such a case the true equilibrium will be destroyed.*

The English bank rate is a penalty rate and dissuades members from borrowing by this means.[41] Again there is a uniform market rate there, which banks charge their customers. Such rigid uniformity does not exist in any of the money markets of this country. Besides there is no competitive market for money. Hence the problem of levying a penalty rate would not be solved easily. But this much is certain. Whenever scheduled banks tend to overborrow this penalty rate has to be imposed.

If this be not acceptable it remains to discuss the possibility of accepting the second method. Although our *Hundi* approximates closely to the commercial paper of the American money market, still the bill rate does not exist for few bills are drawn in internal trade transactions and accepted by the banks.[42] Besides there is a tradition which exists in the American markets which dissuades the member banks to borrow on all occasions. It is not only true that the Central

41 The Central Bank of Switzerland, the Bank of Sweden, the Bank of France and the Bank of Germany similarly maintain their bank rate at a higher level than the market rate. This is the policy of almost all the European Central Banks.

42 See Mr. A. Bowie's Evidence before the Hilton-Young Commission.

Bank, *i.e.*, the Federal Reserve Banks, carefully scrutinise their position but some suspicion, if not aspersion, is cast against these habitual borrowers and "no bank can hope to run counter to this wholesome and desirable public sentiment." Without such a tradition on the part of the Indian public it would be impossible to deter our scheduled member banks from freely tapping the central reservoir on all occasions and making a too free use of the rediscounting privilege and thus tend to destroy the liquidity of the banking system. Hence it would be dangerous to keep the bank rate always lower than the market rate for bank acceptances. In as much as the member banks' endorsement is to be had in the case of discounting by the Central Bank the price for this endorsement has to be ascertained. If the Central Bank charges a rate which represents the true value there would be no temptation to the scheduled or member banks to borrow except for legitimate purposes.

The true value of the Bank's endorsement and the discount policy can be discovered by a process of trial and error just as has been done by the Federal Reserve Banks. The Central Bank's discount rate will be between the bazar rate for hundies and the price charged for bank acceptances by the bankers in the open market. When once this open market rate for bank acceptances has been arrived at the other money rates in our national money markets should be practically moving in relationship with the Reserve Bank's discount rate. Nothing higher than a fair price has to be charged by the authorities of the Central Bank. To facilitate bank acceptances a lower discount rate than in the case of commercial paper can also be adopted successfully.

The commercial bills that can be discounted should be *short-term self-liquidating bills representing bona-fide* commercial transactions. Discriminatory rates of interest higher than the bank rate should be imposed on advances made on bonds [43] and stocks collateral for speculative purposes. The bank rate policy cannot be effective unless there is an active discount market and every attempt must be made to develop an active discount market.[44] An active discount market can

[43] These are known in the London Money Market as Lombard Loans and the Bank of England charges a higher rate than the official rate.

[44] See the chapter on "Banking Organisation," Section on Bills of Exchange.

be created by low rates of interest on the part of the Central Bank and activity on the part of the indigenous bankers, shroffs and banks in accepting, buying and selling freely the bills of exchange. Bank acceptances arising out of foreign trade transactions should also be rediscounted by the Central Bank whenever it is possible to do so. If these methods are adopted it can be seen that a satisfactory development of the discount market would continue. These were some of the very methods adopted by the Netherlands Bank to create a discount market in the country.[45] The Central Bank of Issue should always possess a portfolio of best bills of exchange or of a relatively small amount of most desirable forms of short-term Government indebtedness to be used for mobilising funds from the market or "mopping up" the surplus when it is considered necessary to control the other money rates in the money market. *A stable rate of discount is of the greatest importance to the nation.* It should be raised not needlessly but only when economic conditions such as unfavourable exchange, volume of production, domestic speculation, activity on the Stock Exchanges and high rise in the general price-level demand such an increase. At such times it has to raise the bank rate to any height, whatever might be the state of the reserve, if the volume of credit fails to call forth a corresponding increase of production and when speculation and inflation begin to take place. The C. Bank should discount liberally but always at a high rate during the period of crisis and this is the only method by means of which the disastrous consequences of a crisis can be averted. As MacLeod says, "the restriction theory in a commercial crisis is a fatal delusion. The only way to avert an impending panic is to give prompt, immediate and liberal assistance to all houses which can prove themselves to be solvent at the same time allowing all houses which are really insolvent to go to the wall." [46] The C. Bank should not raise its discount rates during purely 'seasonal drains' and 'speculative drains.' A recent writer prepares a chart to show the

45 See the English Edition of the Report of the Nederlands Bank, 1926-27, adopted from the Economic Journal, December. 1927, pp. 622-24.

46 See H. D. MacLeod, "Elements of Banking."

seasonal trend in rates of interest. Both the monthly averages and the general averages for all months are useful for the administrator or the Government Officer-in-charge of the Paper Currency machinery and to whom is entrusted the task of providing seasonal currency. *The task of issuing additional currency in the busy season is the sole duty of the Central Bank which is to act as the currency authority at the same time.* It is floating credit that is required by the borrowers in the money market. Whenever there was an abundance of such floating credit the bank rate never rose to a higher proportion than 6 per cent. in our money markets. This was the case during 1914-15, 1917-18, and in 1925-26. So a liberal supply of note and deposit currency at that time would suffice and the C. Banker can easily provide such emergency currency at the time of periodic calls in the busy season. This is the ideal and universally accepted solution.

If an abnormal feature like the Government management of currency were to exist it would be incumbent upon the Government administrator to provide emergency currency at a scale of charges acceptable to the business public. But there is no need in this book on banking,[47] which insists only on the ideal management that has

[47] Mr. B. B. Dasgupta says that neither in Mr. Shirras' otherwise useful work and Mr. Rao's recent study of Indian Banking except in Mr. Keynes book—do we find the quantitative measurement of seasonal fluctuations or any thorough attempt at dealing with the question of periodicity. My book deals solely with the banking system of the country and apart from pointing out the defective nature of the present-day seasonal emergency currency much scope would not be forthcoming in a work of banking alone to deal with currency also. Mr. Keynes was writing on both currency and banking. This feature alone made me pay slight attention incidentally to this emergency currency. Even *now I am of opinion that this supplying of currency at times of seasonal periodicity is the most inefficient method of providing currency to meet seasonal demand.* It is credit currency that might expand and there is no necessity to impose a heavy burden on businessmen by charging a high bank rate. In his attempt to point out the scale of charges for the successful administration of emergency currency he has altogether forgotten the ideal of a steady bank rate and the expansion of credit currency by the Central Bank. It is indeed deplorable that he has grasped only the shadow and not the real substance. Both in pre-war Germany and Canada whenever such seasonal demand for currency arose there was no penalty bank rate imposed in any one of the above countries. It is a matter of common knowledge that pre-war Germany allowed an extra-issue of 200,000,000 marks at the end of quarters. Canada still persists on an over-issue of bank notes up to 15% of the combined capital plus surplus in addition to the notes outstanding at the opening.

to be attained, to discuss the scale of charges which the Government (currency authority) have to bear in mind in providing emergency currency which must be secured not only in a sufficient quantity to satisfy legitimate needs of trade but also at a rate compatible with the economic interests of business.

The keeping of the exchange value of the Rupee at 1*s*. 6*d*. and the par points round it would be one of the bounden duties of the C. Bank and the most helpful thing. In this direction, apart from the credit control it can exercise is the acquisition of a portfolio of foreign bills drawn on gold standard countries. This is the only safe method of rectification of foreign exchanges apart from control over internal credit situation. Active buying and selling of foreign exchange when the market rates deviate from the normal specie points is the only method of stabilising exchange within the specie points. This was how Austria stabilised the exchange value of the *krone* during the years 1923-26. The basic idea underlying the operations of the Exchange Equalisation Fund is the same. The proposal of dealing in forward exchange suggested by Prof. Keynes is a valuable aid in controlling the exchange variations, in restricting credit or relaxing credit. Subject to certain limitations [48] this method is as useful as the one of permitting the C. Bank of Issue to vary its buying and selling prices of gold by a margin of 1 per cent. round the statutory prices. Foreign gold bills are considered as valuable assets, important substitutes or complements to the metallic reserve and form a part of the foreign assets of the Central Banks of other countries. First rate Government securities and bank balances in foreign centres are considered as legally equivalent to gold. The following table shows the foreign assets and gold held by some of the Central Banks.[49]

[48] The well-known limitations are that excessive variations in foreign exchange rates mean that acceptance business is liable to be defeated. The forward exchange market of such an undeveloped type as that of India would be unable to absorb such huge one-sided operations. The assuming of the exchange risk has to be done by the C. Bank. See R. G. Hawtrey, " The Art of Central Banking."

[49] See the International Statistical Year Book, 1930-31. The League of Nations, pp. 224-25. See also the monthly bulletins of the F. R. Board of the U. S. A., Reports of Central Banks.

Name of the Central Bank	Domestic currency unit	End of 1913	1924	1925	1927	1929	1930
Union Bank of South Africa.	Gold	8·2	10·8	8·0	8·2	7·5	6·9
	Fn Assets	——	2·2	6 3	7·7	6·6	6·5
National Bank of Egypt.	Gold	2·1	3·4	3 4	3·8	3·8	4·1
	Foreign Assets	1·6	48·9	42·2	28 2	28·3	20·0
Canadian Banks	Gold	46	68	88	98	88	98
	Fn. Assets.	87	112	209	210	72	3[illegible]
U.S.A. F.R. System excluding certificates.	Gold		2242	1940	2030		
	Fn. Assets		——	——	——		
Bank of Brazil	Gold		450	454	407		
	Fn. Assets.		300	113	362		
Bank of Republic of Columbia.	Gold		9·6	15·0	20·5		
	Fn. Assets		13·7	21·3	23·7		
Bank of Japan	Sold at Home						
	Gold and F.A						
The Reichsbank of Germany.	Gold						
	Fn. Assets.						
The National Bank of Belgium.	Gold	346	378	380	719		
	Fn. Assets	232	42	42	525		
The Bank of France	Gold	3517	3681	3684	3681		
	Gold abroad		1864	1864	1864		
	Fn. Assets		69	64	51		
The National Bank of Greece.	Gold	25	64	66	76		
	Fn Assets	227	793	1121	1365		
The Bank of England.	Gold	35	128·6	144·6	152·4		
	Fn. Assets	——	——	——	——		
The Bank of Sweeden.		102	237	230	230		
	Fn. Assets	112	137	202	264		
The National Bank of Switzerland.	Gold	170	506	467	517		
	Fn. Assets	38	193	222	198		
Italy Banks of Issue.	Gold	1376	1550	1553	1593		
	Fn. Assets	197	157	192	1078		
National Bank of Rumania.	Gold at Home	152	135	139	150		
	,, Abroad		428	428	428		
The Commonwealth Bank of Australia.	Gold	4·5	24·9	26·3	20·7		
	Fn. Assets		41·1	49·1	55·0		
The National Bank of Austria.	Gold		11	15	84		
	Fn. Assets		366	567	653		

From this table it is apparent that the recent tendency of most of the newly established banks is to substitute interest-bearing foreign exchange for gold.[50] Some of these C. Banks hold more foreign exchanges than gold. Though this tendency has been scotched as a result of the temporary abandonment of the gold standard by G. Britain it is likely to be resumed as soon as the international gold standard is resurrected. In spite of Dr. Mlynarski's scathing criticism the Gold Delegation did put in laudatory remarks concerning the fitness and utility of the Gold Exchange standard system to the capital-poor countries of the world. The use of interest-bearing substitutes for gold instead of a high proportion of idle specie is also a well-known practice of the C. Banks of Issue. They clearly recognise that the gold reserve is a cause of waste for the Central Bank.[51]

The rationale of this tendency to pay greater attention to foreign exchange reserve and keeping it higher than actual gold reserves is simply this. The main advantage in this portfolio of foreign bills is that adverse foreign exchange can be met suitably without raising the bank rate and contracting credit and prices. This is one of the well-known and desirable methods of the C. Bank to check fluctuations in the bank rate.[52] The holding of the securities is not so advantageous as the holding of the foreign bills. Securities cannot be sold for

[50] See the rules guiding the cash reserve of the Bank of England and Albania. "Gold not less than one-third should be kept against note issue. The Board of Directors have the power to determine the place where the reserve shall be deposited. On the decision of the Board of Directors part of the said reserve which may in no case exceed two-thirds of these, may consist of stable, gilt-edged foreign securities. By the term "Foreign Securities" is meant (*a*) foreign bank notes not subjected to unusual fluctuations in exchange, (*b*) foreign treasury bills payable in gold or in specie not subject to unusual fluctuations, (*c*) bills of exchange expressed in *foreign valuta* not subject to unusual fluctuations payable on the leading markets of Europe and America at not more than three months and endorsed in every case by 2 persons, signatories to the bill and of recognised solvency or by a bank of undoubted solvency. Foreign securities may also consist of assets and funds available at any amount and without restriction deposited in banks of undoubted solvency in the leading markets of Europe and America. (See Spalding, "Dictionary of World's Currencies and Foreign Exchange," p. 3).

[51] According to the F. R. Board's calculation (March, 1927) the leading Central Banks held liquid foreign assets to the amount of some one billion six hundred million dollars of which approximately one billion were held in the U.S.A.

[52] See Liesse, "The Evolution of Credit and Banks in France."

See also Whitacker, "The Foreign Exchange," p. 574.

See also the Renewal of the Reichsbank Charter, pp. 35-40.

large quantities without suffering some loss. Even the Bank of England was often advised to keep a portfolio of foreign bills.[53]

Foreign gold bills are international currency but the apparent danger in this step is that in times of war this country might be cut off from the financial centres in which the assets have been piled up.

It is the duty of the Central Banker to bring exports and imports into a normal balance.[54] In case of unfavourable balance the play of natural correctives can be invoked. Exports can be stimulated by the encouragement of home production and industry. Artificial restraints on trade can be rectified. Internal prices can be made to move in line with international prices so that foreigners may find this country a good place in which to buy. Such measures must be taken by the C. Bank of Issue so that the unfavourable balance of trade would not first of all reduce the foreign credits of the Central Bank maintained specially for the stabilising of the exchange rates. Secondly, the drain of gold from the country would endanger the ability of the C. Bank to control the credit situation. Foreign loans can be arranged in times of excessive fall in exchange rates. If foreign credits do not prove sufficient to support exchange, recourse to foreign loan can be arranged, and if supplemented by the internal loans the unfavourable balance can be corrected easily. The proceeds can be utilised to build foreign credits for supporting the rate of exchange. With the requisite control over internal prices they can be soon brought back into line with the world prices and exchange rates would then tend to remain within the par points. As soon as this is reached the C. Bank can recede from the foreign exchange market.

The Internal Credit policy.

Elsewhere, I have pointed out the means and mechanism of credit regulation pursued by the Central Banks.[55] But regulation

53 See the London Bankers' Magazine, October, 1903, p 443. Note also the reply of Sir R. H. I. Palgrave to this suggestion in the Economic Journal, December, 1906, p. 580.

54 A clear manifestation of this duty can be seen in the import quotas and exchange restrictions which are worked out in consultation with the Central Bank and its holding of foreign exchange assets. See the Reichsbank's action during the years 1933 and 1934.

55 See my book "Elementary Banking," chapter on "Central Bank of Issue and its Relations with the Commercial Banks."

by a C. B. of Issue would be an entirely new innovation in our money market. Clear-cut conceptions should exist as regards the desirability of such control and the means of controlling the general credit conditions should be well understood by our people. The continuous regulation of the credit conditions should be *in the wider interests of the public welfare*. The rate at which credit is created should be high enough to protect gold reserve and prevent inflation but yet not so high as to depress domestic business or make it impossible to relieve trade depression. All the operations of the C. Bank should be guided by the sole principle of accommodating the legitimate needs of commerce and trade There should be no favouritism to particular customers, nor any special touting for business. All borrowing banks, whether big or small, should be treated alike and credit placed at their disposal at uniform rates applicable to all but only to the extent of their financial standing. With proper information collected from original sources from the published reports of central trade associations by a qualified research staff as regards business conditions, labour employment and unsold stock, the Board of Directors of the Central Bank has to regulate its credit policy on the basis of the economic data before them. For a long time to come, mere rule-of-thumb methods would guide the determination of the credit policy of our Reserve Bank. But any due and adequate business can actually forthcome as a result of its proper understanding of the conditions of the borrowing banks, money market rates and conditions, gold movements, movement of funds inside the country, broker's loans, interests of banks and shroffs, saving bank deposits, condition of the foreign banks of issue, money rates abroad, foreign exchange rates, and domestic and foreign financial sales and stocks of business houses The Central Bank would have to collect all this data from the different parts of the country and covering over a wide range of business and banking interests. The ordinary banks would have to issue monthly circulars dealing with monetary and industrial affairs of their customers and more trade associations such as the jute and tea trade possess, would have to furnish reliable data to the C. B. of Issue. Sheltered industries would have to do likewise. Employers of factorytype industries would have to co-operate with the Central Bankers and enable him to know the volume of production and the pace of its development, The Government itself would have to issue a more

accurate general purpose index-number [56] including wages, rates, cost of living, wholesale prices which reflect the state of purchasing power more clearly than an index-number of wholesale prices alone. The major trades and industries can pursue rationalisation and price stabilisation programme thus indirectly aiding the C. Bank in its attempts to level down serious fluctuations in commodity values with all their attendant and disastrous effects on labourers, the consumers and the general investors. They can also co-operate in the conducting of a census of industrial wages.

An enlightened regard for national interests must be the corner-stone on which the business of the C. Bank should be conducted. It should create credit adequate enough to satisfy the legitimate requirements of business. The financing of industry or agriculture should receive due and adequate attention. The increase of co-operative paper that can be discounted from the Provincial Co-operative Apex Banks by the Central Reserve Bank can be limited to nine months and any extension beyond the actual season's period has to be deprecated. A judicious renewal of such paper to deserving Provincial Co-operative Apex Banks would meet with the situation. A Central Bank requires high-grade commercial paper which is promptly paid and the completion of each transaction should have an automatic effect on the volume of bank currency. It is also inevitable that until a discount market is developed the rediscounting of the few available hundies and bills would not satisfy the needs of the situation. For several years to come loans to scheduled banks against promissory notes and under adequate safeguard will

[56] It is impossible to construct an all-India Index-Number while accurate statistics of prices are not available. The construction of an Index-Number by the aggregate expenditure method is feasible and its results might be checked by a collection of family budgets. The Bombay Labour Office published its Index-number of the cost of living of the working classes in 1921. In Bihar and Orissa Index-numbers are being framed at six centres The Labour Statistics Bureau was established by Burma in 1926 and only just recently the cost of living of the working classes has been analysed and separate Index Numbers have been worked for each class (1928). For collecting statistics of prices the construction of an Index-Number according to the aggregate expenditure method must be done and the "weighting" of the commodities of consumption must be done from statistics of imports, production and exports in the case of India as a whole. This would give a fairly reliable indication of inflation or deflation and serve as guide to the Central Bank policy. See also Bowley-Robertson, Report in the matter of family Index-Numbers.

remain the major form of accommodation which the C. Bank of Issue can give to help the financing of the crops and industry. Our inland trade which is roughly fifteen to twenty-two times larger than our foreign trade is mainly financed by promissory notes on demand backed by good names, no doubt, but without any due date fixed therein. Such instruments, however, can be rediscounted. Trade promissory notes representing actual sales and drawn for a period of three months should be freely rediscounted by the C. Bank for the scheduled banks.[57] The quality of credit would be practically at the discretion of the scheduled banks and it is over the volume of credit that the C. Banker can exercise influence. The scheduled banks would borrow as soon as their cash position is deficient and the Central Banker cannot afford to influence the character of employment of credit created by him except in so far as the type of eligible paper is presented by the borrowing banker for securing the credit. As the initiative lies in the hands of the borrowing banks some methods of curbing their anxiety to tap the Central reservoir of credit should be devised. The traditions against continuous borrowing do exist in our market to a certain extent but much reliance cannot be placed on this traditional convention or tendency. The Central Bank must be armed with measures which enable him to check this undue creation of credit. The bank rate weapon and the open market operations are the usually recognised means for this purpose.

Loans.

The maintenance of a minimum reserve to be kept by the incorporated banks with the Central Banks involves the obligation to make loans to them and thus follows the necessity on the part of the C. Bank to be on guard against bad loans. This would introduce standardised methods of accounting and reporting and must duly bring in its train the needed examination by the C. Bank.

[57] I recognise the difficulty of negotiating these and as the rate of interest is fixed and expressed on the promissory note the rediscount rate must be at a level above the fixed official rate for the bill. The endorsement of payee as well as the discounting bank would be necessary. The bankers have to see that these promissory notes are genuine trade promissory notes and do not partake of the character of finance bills.

This would be a new but very wholesome innovation in Indian banking practice. A staff of bank examiners who would be co-operating with the other examining authorities of the joint-stock banks [58] would have to be created to ensure the safety of the loan. Extensive credit files would have to be maintained and the weeding out of the incompetent and inefficient scheduled banks would have to be rigorously done. The C. Bank policy should always be to extend to each scheduled bank borrower such discounts and advances as may be freely and reasonably made with due regard for the claims and demands of other member banks. Impartial service to all borrowing banks should be the watchword of the C. Bank.

Loans ought to be granted for a limited-period to bank borrowers on the security of gold or silver or documents relating to their shipment or storage, on negotiable paper as can be discounted by itself or against merchandise stored in the bank's godowns or bonded warehouses to the extent of two-thirds of its value or against Government and Trustee securities or foreign bills that can be discounted by the Central Bank itself. The short-term advances that can be made to the Government must also be limited in amount and no such advance ought to remain uncollected at the end of twelve months. At present there is no open market for the Treasury bills and it would be the cardinal duty of the Central Bank to encourage dealers to buy and sell Treasury bills and always stand ready to purchase T. bills from the dealers when the market becomes congested or when money becomes firm with the result that call money cannot be secured from the banks at a cheap rate to finance their transactions. The F. R. Banks always undertake to purchase their T. Bills from dealers at such times and this is done on the understanding that they repurchase them at the end of fifteen days. Then the dealers buy and sell the T. certificates at the market price and the creation of this market made the T. certificates a desirable form of employing surplus funds. The absence of such a market for T. Bills is the chief disadvantage and the Government are not aided in the matter of their short-term debt by the money market and high prices are being paid for their sale.[59] There has been some slight improve-

58 See chapter on Banking Legislation.

59 See the chapter on "Recent Monetary Reform."

ment in this direction. The Government were able to borrow three month's money at an average rate of 1·58% per annum against 1·62 in the year preceding. (*Vide* Controller of Currency Report, 1934-35, p. 11) After the advent of the R. Bank conditions have markedly improved and the lowest return on Treasuries can now be secured. The average rate for accepted tenders being eight annas and four pies per cent. per annum (July, 1936).

Administration and Management of the C. Bank.

When currency, credit and discount-policy can be decided by the C. Bank there is no reason why all the members of the Board of Directors, nominated as well as elected, should not be Indian nationals or foreigners by birth but who consider India as the land of their domicile. In the reorganised Reichsbank the managing Board (Reichsbank's Directorium) consists purely of German nationals. It is only in the General Council (General rat) that seven foreigners are allowed and the main functions of the General rat are (*a*) to elect subject to the approval of the Reich's President its Chairman, who is also the Chairman of the Managing Board, the President of the Bank and its managing director, (*b*) to elect the Commissioner for the note-issue by a majority of nine members six of whom must be foreigners. Apart from such control over the Banks as the General Council may exercise through its electoral powers, its functions under the law are advisory—its formal assent not being legally required for any decision of the Managing Board. Thus it is apparent that German nationals alone can control the real policy of the Central Bank.[60]

Annual Report.

The C. Bank should publish an annual report containing a clear statement of its operations so as to enable people to realise how far

[60] Kisch however does not seem to appreciate this point but says that due to peculiar circumstances the General Council must include seven members of foreign nationality. He does not however mention that even if foreigners were to be present here the management is not vitally effected. See Kisch—"The Central Banks—p. 60 (First Edition). See the Memorandum of the League of Nations on Currency and Central Banks—Volume II - (1923-24), p. 69.

the institution has been satisfactorily working and the more intelligent observers may make important suggestions for improving the work of the C. Bank.

Co-operation with other C. Banks.

It has already become the accepted practice of the C. Banks to confer with each other and outline their policies with a view to secure the greatest possible economy of gold for it is feared that the world's production of gold would be on the decrease and a fall in world prices would be inevitable under such a regime of diminished gold production. To prevent long-period fall in world prices ameliorative action would have to be designed by the Central Banks and they would have to be loyally carried out in all countries so that this danger can be averted. It is already apparent that something has been achieved in this direction by almost all countries reducing the amount of gold in circulation and as the credit structure is being perfected in these advanced countries the use of additional gold is discountenanced.[61] The hoarding of gold coins and bars is discouraged everywhere.[62] The C. Banks are mobilising their gold resources and are actually holding more gold resources than in the pre-war days. If, after all, the anticipated decrease of world's production of gold were to take place, the C. Banks can and must co-operate with each other and attempt to settle trade balances by means of international securities. The reserve proportion needed can be reduced further and excess gold liberated to fill up the gap produced by diminishing gold production. Propaganda for lessening the industrial use of gold should also be undertaken. Resort to barter to satisfy one another's requirements can also be thought of. At such a time it would be the duty of C. B. of the country to carry out loyally the suggestions intended for further economy of gold and readily share the burden of the world's gold standard system in common with the other C. Banks.[63]

[61] See Prof. J. M. Keynes, "Treatise on Money": "Almost throughout the world gold has been withdrawn from circulation. It no longer passes from hand to hand."

[62] See my article, "America's Abandonment of the Gold Standard," October, 1933; Indian Journal of Economics.

[63] For a further discussion of the topic see the chapter on "Banking Management."

The practical difficulties in the path of the Central Banks.

People entertain some doubt as to the practicability of a successful and effective working of Central Bank in this country. It has indeed, a rough and rugged road to travel before it can overcome the traditional habits of the people. It is quite probable that the best way of starting a C. Bank of Issue is to proceed from below upwards. That is, if there are a large number of joint-stock banks the Central Bank can function smoothly and enlist their support in improving the monetary structure of our society. It is true that there is no bill market where a sufficiency of bills can be secured as cover for further financial facilities at the hands of the Central Bank. In the absence of such bills accommodation can be granted only on promissory notes under adequate safeguard. A change in the banking habits of the people can be brought about by persistent propaganda work in this direction. Genuine trade bills can be created by banks agreeing to accept bills drawn on them. These bills can be called into existence by the creation of acceptance houses and a discount market. The Multani Banks and Chetties can do this business of accepting and discounting bills if they are sure of rediscounting facilities with the C. Bank. The money market always develops round the C. Bank. In its attempt to become self-supporting the C. Bank would have to frown upon and discourage all habits which retard or prevent the development of the useful bill of exchange. This is what the F. R. Banks had to do. It is undoubtedly true that India presents greater difficulties. Although these difficulties would be embarrassing and acute they have to be faced and they are by no means insuperable.

Secondly, there are not also many indigenous joint-stock banks. Without a network of banks the C. Bank cannot be a success. It may be considered that the time is not ripe for the C. Bank as a sufficient number of well-developed constituent banks are not in existence. We cannot hope to build a sound banking structure from the top instead of from the bottom. But the experience of other countries refutes this line of reasoning. Even when the banks are few there is no real unified control over the credit situation at present, thus making monetary stability an impossible thing in India. Without the Central Bank as the sheet anchor of credit, as the custodian of the ultimate banking reservoir of the country and as a central

rediscounting agency, it is not possible to have well-spread joint-stock banking in the country. The effective control of bank cash lies solely in the hands of the C. Banker. We have already seen how every C. Bank's purchase and every loan by a C. Bank increases the cash reserves of other banks. They provide the basis for the creation of bank money. Similarly every sale by C. Bank can reduce bank cash and restrict the supply of money. It is entirely erroneous to consider that it is gold movements that can control the volume of money. The purchase and sale of non-gold assets by a C. Bank can regulate the volume of bank cash or credit money in any society.[64]

Conclusion.

The efficient and successful functioning of the C. B. of Issue depends on two factors, a constitution with all its provisions carefully laid down especially those referring to rediscounting and open market operations and secondly the policy to be adopted by the practical administrators of the bank. It can be said without hesitation that the provisions on the whole should reflect thoughtful and careful work on the part of its framers and embody such rules and customs as have been proved to be wise and wholesome by the experience of the C. Banks of other countries. Provision for a regional basis of the C. Bank of issue must be made with due reference to the economic importance of the various parts of the country. In providing for a deficiency in the reserve it should secure liberal conditions which would not hamper heavy rediscounting by the C. Bank. The commercial paper and bills of exchange that can be discounted must be limited to a maturity of ninety days and in this respect the best of the practices of other countries must be followed. Even the character of the bill of exchange eligible for the C. Bank's portfolio should be carefully defined.[65] In the matter of

64 See the Report of the Macmillan Committee for the different types of "open market operations."

65 It is unwise to depend on instructions of the banker in this matter. A former head of the House of Rothschild always depended on his tongue and remarked that he could discover a genuine trade bill from a finance bill as the salt on the bill would show that it really crossed the sea. Another expert French Banker said that he always depended on his nose

financing agricultural industry the extension of the time limit to nine months is an absolute necessity and need not be regarded with any apprehension or fear. In the F. R. system of the United States of America, agricultural paper maturing within nine months is eligible for rediscounting. The Reichsbank affords an exceptional treatment to agricultural paper and allows one renewal in its case. The Central Bank should be empowered to lend for three months on promissory notes of scheduled banks for holding or trading in securities of the Government of India or local Government but there should be a limit to the amount of credit that can be extended in this direction and it should also be lent at a slightly higher rate, say by ½ per cent. at least, than what the C. Bank would charge on trade and agricultural paper, otherwise a mere financial use of money can be made, thus sacrificing the legitimate demand and use of money. A slow and steady growth of bank acceptances would tend to create a discount market in the important internal monetary centres. Powers of direct discount of such bills as are eligible for rediscounting must be granted and the open market operations can be conducted judiciously at the initiative of the Board of Directors. This should be freely exercised if interest rates are abnormally high in the market. It should also serve to develop the discount market, to control the movement of gold, to rectify the exchanges and assist in the financing of the foreign trade of the country.

The raising of the bank rate, the open market operations of the C. Bank and moral persuasion are now admitted as the best methods in regulating the credit situation in all countries. Stability in economic life is now the chief criterion, and mere credit expansion at unduly low rates of discount tends only to increase the amplitude of cyclical fluctuations with alterations of inflated profit and heavy loss. The Central Bank should respect all the established tenets of discount policy. The official responsible for the working of the C. Banking system should not fail to profit by the lessons of European Central Banking experience. The rediscounting policy should not be merely opportunistic. It is indeed true that the human equation cannot be

to do it for it enabled him to smell of the produce against which it was drawn. While systematising the money market such things cannot be allowed to work satisfactorily.

eliminated in Central Banking. But their efforts to control credit and prices should not be of such a character as to be misunderstood by the people. Although stability of exchange is to be one of the chief objects of the C. Bank still it should not become its sole pre-occupation. Nor should it regard itself as merely an agency for supplying emergency currency in the busy season and alternating crises when they occur. The authorities must keep in mind the broader general economic well-being and the progress of the whole country and fluctuations in bank rate must be guided by changes in the general price level and other data relating to healthy and legitimate trade and industrial production. The essential need of the future is to secure the maintenance of the economic progress, with a growing population and ever-improving standard of living, both of which require an expansion in the volume of production and trade. This can be done by the C. B. of Issue thoroughly overhauling the technique of our credit and currency system. Judgment, tact, broad economic knowledge, energy and initiative are essential on the part of the executive officers of the Bank and they should be actuated with no other motive than a single-minded devotion to the wider national interests and try to discharge them without sacrificing its well-recognised responsibilities. They must be infinitely wise and infinitely virtuous at the same time. They must pay heed to tradition, precedent and authority and act as a steadying and stabilising influence on the banking community of the country and its general financial and industrial mechanism. The people on the other hand should develop central banking habits and general banking outlook.

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CHAPTER III

The Reserve Bank of India.

(A Criticism of the Act.)

Introductory—Popular opinion not satisfied—Shareholders' constitution examined—Other omissions—Not sufficiently amenable to Government influence—Management—The Local Board—Nature of its business—Bankers' Bank—Government banker, individual depositor—Discounting business—A necessary brake—Banking dont's—Discounting business—Buy and sell Government securities—Loans and advances—Fair field and no favouritism—Bankind cartel—Other items of business—Buy and sell sterling exchange—Note-issuing business—Unsatisfactory principle—Consolidation of the two departments—Holding of cover—Securities—Importance of sterling resources—Silver Rupee holding—Suspension of asset requirements—Relations with other banks—Imperial Bank as the sole agent—Branch expansion—Indigenous bankers—Exchange banks—Co-operative banks—Agricultural finance—Modernisation of indigenous banking—Necessary safe-guards—Annual Report—Enforcement of banking legislation—Governor-General's interference—the supervisory Banking committee—Public trust—Initial difficulties—Some proximate advantages—Long-period advantages—India's needs.

Introductory.

At last the Reserve Bank Bill of 1933 has been approved with certain slight modifications brought about by the Indian Legislative Assembly. The Reserve Bank of India[1] assumed its currency and banking functions after the close of the year 1934-35. London High Finance or City interests have succeeded in rejecting a previously recorded and formally ratified decision, *viz.*, a state-owned and managed bank on the ground that " it will lead to unnecessary political interference." As the successful functioning of the Reserve Bank depends on a carefully formulated constitution the Reserve Bank Act has to be scrutinised to see if it has been wisely conceived. It has been considered " better wisdom to start a shareholders' bank " but the constitution does not sufficiently warrant the possibility of exercising national control over the national currency and credit policy of the country nor is the shareholders' constitution as at present devised free

[1] For a full and detailed study of the R. Bank the authors' forthcoming work on the R. Bank has to be consulted.

from political influence on both sides of the sea. The broad outlines of the monetary standard, its organisation and policy which ought to subserve the real needs of the country have to be formulated by the Legislative Assembly—which is the microcosm of the entire state itself but this elementary right stands vetoed or depends on the caprice of the Governor-General (see sec. 153 of the Government of India Act 1935) who might not permit the introduction of any legislation concerning currency and exchange policy if it were to run counter to the pursuit of the policy of Economic Imperialism on the part of the British capitalists.

National or popular aspirations.

Apart from pointing out that monetary autonomy is not vested in the sovereign legislature of this country, the Reserve Bank's constitution has been so devised that it does not fully satisfy the national aspirations of the people.[1] The fixing of exchange ratio of the Rupee itself between 1 *s*. $5\frac{49}{64}$ *d* and 1 *s*. $6\frac{3}{61}$ *d* has been against popular opinion. Though the Legislative Assembly has decided in favour of an improved form of shareholders' type still there are certain defects which have to be amended in due course of time. The fact that British subjects of those Dominions which discriminate against Indian people have been disqualified from holding any shares of the Reserve Bank is a decided concession in favour of Indian popular opinion. The possibility of increasing or decreasing the share capital of the R. Bank according to the necessity of the situation has also been secured by the R. B. Act of 1934. Some sort of rough economic justice is secured by allotting increased amount of share capital to the more wealthy and important provinces.

1 Each share is worth Rs. 100 and is a fully paid one and no individual is to ordinarily hold more than 5 shares. The lowering of the minimum denomination makes one believe that the small capitalist would be preferred.

(Western) Bombay Register [2]	...	1,40,00,000	Rs.
(Eastern) Calcutta Register	...	1,45,00,000	,,
(Northern) Delhi Register	...	1,15,00,000	,,
(Southern) Madras Register	...	70,00,000	,,
(Burma) Rangoon Register	...	30,00,000	,,

The economic importance of Bombay and Calcutta is further secured by the provision of permitting the shares of the value of 35 lakhs to be subscribed therein if lesser applications were to be received from the Delhi area. Now that Burma would have a separate monetary system apart from that of India the Rangoon Register would have to be closed and the shares distributed between the other countries.[3]

Companies registered under the Indian Companies Act of 1913 or Co-operative Societies Act of 1912 can become shareholders. A scheduled bank can thus become a shareholder. Although this clause would render possible undue control of the R. Bank's policy by the foreign exchange banks for a company incorporated under the Act of Parliament can become a shareholder, it has been wisely enacted that no bank officer except that of a co-operative bank can become a director of the R. Bank. As Urban co-operative banking is tending to approximate to commercial banking the joitnt stock banks would consider this preference to them as an unjustifiable one. The restricting of the right to vote by proxy except by a brother shareholder is a wise one. The principle of one vote for every five shares and ten votes as the maximum number for any shareholders would certainly tone down the influence of the rich capitalist shareholders. The limiting of the shareholders' right to the state and position of annual accounts of the C. Board is a wise measure and political snipe-shooting by democratically-minded shareholders is prevented thereby.

[2] Either the cry for separation of Burma from British India is an insincere and got-up agitation or else this insistence of share-holding would not be made.

[3] The present capital of 5 crores is too meagre for the whole of the Government deposits are being handed over to the shareholders' bank. Secondly, the number of scheduled banks is 51 and of these 19 are foreign Exchange Banks. Unless the Reserve Bank's capital is on the increase the lowering of interest rates in the interior cannot be secured at any time.

Share concentration is feasible in the hands of rich capitalists of either Bombay or Calcutta for there is no *maximum limit* up to which shares can be held within these areas. By process of transfer or *benami* shareholding concentration becomes ultimately possible though in the beginning nobody may be allotted more than 5 shares in *any* area and *no shareholder* can be registered in more than *one* area.

The necessity of purchasing shares on the part of nominated directors has to be decried for these are being recruited for the sake of their banking knowledge. The compulsory holding of shares secured at par value to the extent of Rs. 5,000 appears to be an unnecessary caution. This leads to the withholding of certain shares of the value of 2 lakhs 25 thousands from the public to be sold at par to the nominated directors and the reselling of these at par-value to the Government by the nominated director as soon as he ceases to be a member.

Other omissions.

Though a happy fusion of nomination and election features in the composition of the Board has to be approved yet it is not distinctly laid down that the four nominated non-official directors should be men actively connected with finance, agriculture, commerce or experts possessing banking knowledge.

If the Government-nominated official director were to merely attend and not ordinarily vote nor *suspend any action* his mere so-called watchfulness would be of doubtful utility. On several occasions the Government directors of the old Presidency banks failed to rise equal to the occasion and check frenzied banking practices. [4]

The absence of special provision that the Governor-General would not be prejudiced by racial or communal feelings in the matter of selection of the Deputy Governors might lead to any abuse of the privilege.

Although the principle of securing continuity of policy is essential for successful banking administration there ought to be frequent changes at the end of 5 years in the case of the nomination of 4

[4] See my book " Organised Banking in the Days of John Company," Chapter on the Bank of Bombay.

non-official Government Directors to the Central Board. One is apt to be apprehensive in this direction for the nominated directors of the Imperial Bank were almost always the same old individuals although some of them were octogenarians.

It is laid down that no director or member of the Local Board should continue to sit in the Central Legislature or Legislative Council of the Province. But this provision by itself does not guarantee the immunity of the Bank from the political influence of the legislature. Such national issues as the currency and credit policy of the country would always be live issues and are bound to influence the acts of the legislature and be influenced by its actions. Though in practice shares have been allotted to Indian nationals still it is not legally enacted that non-nationals will not be allowed to hold shares. Even if they were to hold shares they should be prevented from taking part in the deliberations and vote at general meetings.

Government Influence.

The possibility of making the R. Bank a state-managed institution though owned by shareholders as in the case of Norway's C. Bank has been negatived. Although the Governor-General-in Council nominates all the directors in the first instance, there is election of the same hereafter and though a few and usual disqualifications are enacted still the management of the R. Bank by state-nominated directors becomes impossible. The capitalist shareholder might fail to appreciate the Government point of view and though the profit-hunting motive can be easily subdued it becomes less amenable to Government influence than it would otherwise be the case. This appears to be anomalous in these days of "social control" over Central banks.

Management.

The Central Board of Directors consists of 16 members. The Governor and the two Deputy Governors who are full-time officers will be appointed from out of a panel selected by the C. Board by the Governor-General-in-Council. Four Directors will be nominated by the Governer-General-in-Council. These would represent economic interests which stand unrepresented by means of election. Agricultural

and co-operative interests might secure representation through nominations in case they would fail to be elected during normal stages of election. Eight Directors are to be elected by the different local boards ; two for Bombay ; two for Calcutta ; two for Delhi ; one for Madras and one for Rangoon.[5] A Government *official* may be nominated in addition to the four nominated non-official Directors.

Each *Local* Board has to elect five Directors from amongst the shareholders. Three Directors are to be nominated by the Government from among the shareholders' register and the representation of agricultural, or co-operative or other important territorial economic interests can be secured thereby. The formation of the policy lies in the hands of the Central Board and the Local Boards are to advise the Central Board on matters referred to them. They have to transact such business as is entrusted to them by the Central Board. The annual meeting of the shareholders which is to be held within six weeks from the date of closing the accounts of the bank can be convened alternatively in different centres so that undue predominance of either Bombay or Calcutta can be checked thereby. Due provision has been made for the increase of branches in such provincial or regional areas as the Central Board may consider it essential to possess one.

The Nature of its Business.

As the name itself indicates its business the Reserve Bank has to act as an efficient " lender of the last resort," as " a shock-absorber " and as " an emergency bank " to which all eyes may be turned for help, advice and guidance. As the Macmillan Committee so graphically puts it : " it has to keep the financial structure of our country on an even keel." The issuing of bank-note currency and the running of the credit structure in the interests of the nation are the specific duties entrusted to the Reserve Banks. This can be achieved by a policy of comparative stabilising of business activity, by controlling

[5] While schemes are being formulated for this separation of Burma from British India no such arrangement as the above one was carried out. Its shares should be distributed equally amongst all other centres in case Burma secedes from the Federation.

the money market, the maintaining of a sound monetary organisation and securing equitable rates of exchange.

Bankers' Bank.

Adumbrating this essential idea it can be stated that it has to act as the bankers' bank, and as the Government banker. Maintaining compulsory reserve-deposits of the scheduled banks it has to undertake the function of clearing and collecting cheques and bills and other credit instruments for the scheduled banks. By means of rediscounting the C. R. Bank has to expand the reserve deposits of the scheduled banks so that the expansion of credit can be secured. It can also be done by conducting " open market operations " which tend to expand the scheduled bank's reserve-deposits or balances.

The Government Account.

Acting as the Government banker it has to collect and disburse the Government revenues, manage the existing public debts of the Government here in India as well as England, float new loans *in India* or *London* [6] or *abroad as and when* required and finance the needed exchange and remittance operations of the Government. While so doing the C. R. Bank has to undertake special measures to see that the vast financial operations of the Government do not derange the money market, *viz.*, the inflow of revenue, the making of interest payments and the holding of vast loan sums collected as subscription to Government loans would produce serious consequences. As " guardian of the money market these shocks have to be absorbed by the C. R. Banker. There should be neither plethora nor shortage of credit as a result of its operations."

Private Deposits.

The moot point in this connection is the necessity or otherwise to maintain direct contact with individual private depositors. Strictly

[6] This has to be done after securing the needed Parliamentary sanction to float loans outside India.

speaking an emergency bank is meant to act as the final resort for financially harassed or embarrassed individuals. If our R. Bank is to be guided by sole theoretical considerations the attracting of private accounts has to be considered. But as banking experience of other countries notably that of South Africa and Japan points out the necessity of direct contact with individual borrowers of the money market, it ought to be easily established for without it the expenses might not be covered nor can an easy control of the money market by variations of reserve-deposits or balances be secured. Coupled with the necessary advice that such accounts tend to lead to further entanglements which might defeat the particular aim and objective of the C. R. Bank and that national service and not private profits should be the actuating motive of the central banking action the holding of private non-interest-payable-accounts may be tolerated. But in the actual daily routine of its operations the sound convention that such accounts should not be held for large figures as it has been the case with the Riksbank would have to be rigorously followed.

Correspondent Business.

As international central banking co-operation is needed to secure monetary rationalisation and comparative stabilisation of world prices our C. R. Bank should act as the agent of the C. Banks of other countries and where it has no direct branch of its own it should appoint the C. R. Bank of the foreign country as its agent. It can also keep balances with banks in the United Kingdom.

A necessary brake.

It has to eliminate the failures of sound banking concerns which are temporarily embarrassed for some reason or other.

Banking dont's.

It is however imperative to negatively define the field of its operations by mentioning a few lines of business which the Reserve Bank of ours should not undertake at any time. It should be engraved on the foundation stone of the C. B. structure that the bank shall not

draw or accept bills payable otherwise than on demand, shall not trade or have any interested undertaking in commercial, industrial or trading concern, shall not engage in general exchange operations on its own account, shall not make unsecured loans or advances on land or mortgage security and shall not open indiscriminately branches outside the country and shall not effectively compete with the scheduled banks either in the securities market or bill market. By all means access to the arcana of the money market should be in its hands. The Reserve Bank should not also allow interest on deposit or current accounts.

Discounting Business.

The Reserve Bank is permitted to discount or purchase bills of exchange and promissory notes drawn and payable in India which arise out of *bona-fide* commercial or trade transactions—the condition here being that they must bear at least two or more good signatures one of which must be that of a " scheduled bank and that they must mature within 90 days from the date of purchase or rediscount exclusive of the days of grace."

The R. Bank can rediscount or purchase or sell bills or pronotes drawn or issued for the purpose of financing agricultural operations or marketing of crops and maturing within *nine months* from the date of purchase or rediscount exclusive of the days of grace.

The R. Bank can purchase or sell or rediscount Treasury bills drawn in the U. Kingdom maturing within 90 days from the date of purchase. Such transactions can be permitted in India through the scheduled bank alone.

While bill-discounting business is carefully outlined it is indeed remarkable to notice the absence of the open market Investment committee to guide this nature of this type of banking business. Without such a committee the buying of bills in the open discount market would be misconstrued.[7] This can be formed by virtue of arrangements to be made by the Central Board.

[7] *Vide* the memoranda of Mr. (now Sir) S. N. Pochakanawala before the Joint Select Committee. But the buying and selling of bills in the open market need not be given up by the Reserve Bank for the following reasons. This would run counter to modern central banking traditions. Secondly, the quality of the eligible bill which can be discounted would

The Reserve Bank can purchase, sell and rediscount bills of exchange and promissory notes drawn and payable in India and bearing the signature of a scheduled bank and issued and drawn for the purpose of holding or trading in securities of the Government of India, or a Local Government or securities of such Native States as are recommended by the Central Board and maturing within 90 days from the date of such purchase or rediscount.

The R. Bank can buy and sell Government securities. The undue variations in the value of even the Government securities is a sad phenomenon in the stock markets. Comparative stabilisation of their value would greatly aid the operations of all financial institutions which tend to keep them in their reserve. Commercial banks themselves, would be gainers in the long run for the present-day wiping off of gross profits to cover depreciation of gilt-edged securities would not result in diminishing the profits or gains of banking operations. The Reserve Bank can buy and sell Government securities of the United Kingdom maturing within a period of ten years.

model for the ordinary joint-stock bankers. Thirdly, the right to buy bills and securities would greatly strengthen the credit expanding and contracting power of the C. R. Banks. Fourthly, the limitation of discounting privilege to scheduled banks' bills alone would delimit the volume of its business and restrict its ability to cover its working expenses. Fifthly, eligible bills are the most liquid of bank assets and if these are not to find a place (except through scheduled banks) the C. B. portfolio would not be so very liquid. Sixthly, the absence of a bill market is a deplorable feature and the tendency to have rediscounting of bills would delay the early formation of the discount market. Seventhly, the South African Reserve Bank which acted purely as Reserve or Bankers' bank alone was soon forced to develop open market operations to control credit and to earn decent profits so as to cover up its working expenses. Eighthly, the extent of dealings in the volume of Government securities might not be powerful enough to secure credit control. Hence it should be reinforced by dealings in bills. The recent emergency legislation of 1932 and 1933 has empowered the F. R. system to rediscount directly for the public. All this was done to have a great expansion of credit. Sir Ernest Harvey in his evidence before the Macmillan Committee admits that reduction of credit has to be secured firstly, by the sale of bills and the raising of bank rate cannot always be pitched upon as the credit regulator (Qs. 7520 and 7521). Ninthly, the deliberate refraining from open market discounting business would itself have the needed efficiency in controlling the volume of credit. The above reasons lead to the conclusion that the right to buy and sell bills and securities and direct dealing with the discount market should be granted. The open market operations can control the scheduled bankers' cash which is the basis of credit. When it is felt necessary to give a fillip or raise the domestic price level open market operations can be hit upon

Loans and Advances.

The Reserve Bank can lend to the Native States, local authorities and provincial co-operative banks against eligible securities, *viz.*, recognised trust securities, gold and silver or documents of title of bills and promissory notes eligible for purchase by the bank, promissory notes of scheduled banks, provincial co-operative banks which are supported by documents of title to goods and which were assigned or pledged to such banks as security for a cash credit or overdraft granted for *bona fide* commercial trade transaction or for the purpose of financing seasonal agricultural operations.

The Reserve Bank can lend to the Governor-General in Council and other Local Governments for the purpose of management of their revenues. But unfortunately the Act is indeed very vaguely worded in this connection. The specific item of Government advances has not been limited to any particular figure. If limited to pure ways and means Advances they do not form an element of danger to banking stability. If banking independence must be secured at any cost there should be no power on the part of the Federal Legislature to make the Reserve Bank lend more except on its own initiative and proper examination of the Government's loan proposal. The liberty to purchase Treasury bills has been granted. If the State can make any direct demand they may be complied with. *Complete independence as against the State's direct demands for advances must be secured.*[8] Prof. Cassel points out that though the Riksbank is a State Bank and is owned by the "Riksdag" it maintains an independent position even against the "Riksdag." It is indeed curious to observe that while a limit has been fixed to the borrowing privileges of the Reserve Bank in India,[9] no such limit has been imposed on its advances to the state.

[8] Taking Sir Otto Niemeyer's new plan for the Reserve Bank of Argentine we find such a limit placed by him. The 1927 charter of the Bank of Greece drawn up by the League of Nations limits the temporary loans to the state up to 400 mil drachmas and requires payment within 3 months of the close of the financial year. Even in the charter of the Bank of England this right to grant loans to the State on the bank's own initiative is wisely curtailed.

[9] It can borrow for a period of one month alone on giving security and for conducting its business. This loan can be secured from any scheduled bank. Outside India it can

It need not be emphasised that a dangerous abuse of this privilege would mean serious consequences.

Another notable omission in the Reserve Bank Act is the necessity of encouraging loans and advances on warehoused goods. But the Reserve Bank should own a few warehouses or licensed warehouses can be encouraged in this manner by declaring their receipts as an acceptable collateral for granting loans.[10] The perfecting of agricultural marketing can be secured in this manner. Cheap agricultural finance can thus be ushered in. [See paras. 419 and 420 of the Central Bank Enquiry Committee Report. This was negatived by the London Reserve Bank Committee. (See para. 17 of their Report.)]

Fair field and no favouritism.

When it is meant that in addition to rediscounting ordinary loans and discounting in the open market should be made by the Central Reserve Bank the cardinal duty of equitably distributing the resources of the Central Reserve Bank should not be forgotten. Fair field and no favouritism ought to be its watchword. Equal care and paternal affection should be bestowed on all. An impregnable banking system should be created under its watchful guidance. The mere holding of the deposits of scheduled banks at the rate of 5% of the "demand liabilities" and [11] 2% of the "time liabilities" by the Reserve Bank would lead to a building up of the national banking reserve in its hands.[12]

borrow from the C. Bank of the country alone. These borrowings can amount up to the amount of its share capital alone.

[10] So long as the bill market is conspicuous by its absence lending on warehouse receipts might be tolerated. In the slow evolution of time as the bill market becomes perfected this type of loaning has to be gradually given up. More liberal terms in the matter of discounting can be granted than in the case of loaning on collaterals and precious metals. The present-day business methods dominated as they are by cash credits and open credits would have to be changed.

[11] Failure to comply with this provision means a penalty of 5% above the bank rate being levied on each date of deficiency. The prohibition of new business on the part of the scheduled bank could safely be insisted upon.

[12] At the time of publishing its report on each Friday the bank has to calculate the exact liabilities—demand as well as time—*i.e.* The paid-up capital, the reserve and the credit balances of the profit and loss account and the amount of any loan taken from the Reserve Bank ought to be excluded from the demand or time liabilities.

Bank Cartel.

India needs centralised reserve banking both by way of reserve and deposits and by way of rates of interest. It is not mere centralisation of reserves but a uniform deposit rate which will conduce towards stability of the banking business. All other improvements such as useful clearing arrangements, spread of banking knowledge, and wise banking legislation pale into[13] insignificance before these two cardinal features.

Other items of business.

The Reserve Bank can issue Bank Post Bills and demand drafts payable at its own branches. It can act as a bailee for hire or reward and take moneys, valuables and securities for safe custody. It can buy and sell gold coins and bullion on its own account. It can invest funds in shares of the Bank of International Settlements. It can act as agent for specific fnnctions such as purchase or sale of gold and silver, bills of exchange, securities, collection of proceeds whether principal, interest or dividends of securities of shares and remittances of same by bills in India or elsewhere.

Above all it can sell or buy *sterling* in amounts not less than Rs. 100,000 to the scheduled banks. Though not for its own account but for satisfying the requirements of its scheduled banks foreign exchange transactions (sterling) have to be conducted. It has to buy and sell sterling for delivery in London at a ratio not below 1*s*. $5\frac{49}{64}d$. and 1*s*. $6\frac{3}{16}$ths of a penny for the Rupee. No sterling purchase or sale to any person should be below 10,000 pounds sterling.

Note-issuing business.

The privilege of issuing legal tender bank notes of the denomination of 5, 10, 50, 100, 500, 1,000, 10,000 Rupees has been granted to the Reserve Bank and the present-day privilege of the Government to issue

[13] See my book entitled "Organised Banking in the Days of John Company"—last chapter.

notes would be cancelled and transferred to the Issue department of the Reserve Bank which is to be kept entirely separate from that of the Banking department. The Issue department becomes liable for converting its own notes and the currency notes of the Government of India.[14] Against these total liabilities of the Issue department it maintains assets in the shape of gold bullion, gold coins and sterling securities. The Reserve Bank has to maintain about 2/5th of its actual nostes issued in shape of gold bullion, coin and sterling securities. The amount of gold coin and gold bullion mnst not at any time be less than 40 crores of rupees in value. The remaining assets can be held in rupee coins, rupee securities and bills of exchange and promissory notes payable in British India as are eligible for purchase by the Reserve Bank. The Government of India rupee securities should not exceed at any time 1/4th of the total amount of assets or 50 crores of rupees which ever amount is greater or with previous sanction of the Governor General in Council such amount plus the sum of 10 crores of Rupees. The valuation of gold coin and bullion is to be done at 8·47512 grains of fine gold per rupee. The rupee coin is to be valued at its face value and securities at their market valuation. As against the total gold holding of the Reserve Bank 17/20ths shall be retained in *India alone* in its own custody or its own branches.

Unsatisfactory principle.

Before criticising the holding of securities, gold and silver items the principle underlying the Reserve Bank note-issue has to be adversely

[14] In return for the liability on the currency notes issued by the Government the Government of India has to transfer to the issue department of the Reserve Bank, gold coins, gold bullion, sterling securities and rupee securities to the aggregate value equal to the total of the liabilities transferred by the Indian Government in connection with its notes in circulation. Gold coin, bullion and sterling securities handed over might be half of the amount transferred and the rupee coin to be transferred should not be less than 50 crores of rupees. All the gold held in the P. C. Reserve or G. S. Reserve should be transferred. This is a thorough unification of all gold items in these reserves in the hands of the Reserve Bank. The G. S. Reserve is the redemption fund against silver rupees issued by the Government.

[15] These sterling securities may include balances at the credit of the Issue Department with the Bank of England, sterling bills of exchange maturing within 90 days, Government securities of the United Kingdom maturing within 5 years,

criticised. While the best way of issuing notes is to appoint a high maximum figure of the same the old and effete proportional reserve system which ought to have been condemned from the standpoint of recent theory has been recommended. The amalgamation of the present P. C. R., the Gold Standard Reserve and the Treasury balances in the hands of the Reserve Bank has been carried out. In so far as bank notes are a reflex of legitimate trading, industrial and agricultural activity they ought to be created in response to due and legitimate demand but due provision has to be made for the prompt retirement of bank notes.[16] It is the building up of sound and liquid assets that is the criterion in Central Reserve Banking. The mere amassing of a stipulated gold minimum proportion is no sign of adequate banking strength nor does the keeping of a "free gold" far above the minimum legal figure, eliminate the cautious necessity of building up sound banking assets. The maximum figure might be safely fixed at 300 crores in the initial days and made to expand if legitimate demand for the same were to be enhanced. The objective throughout should be to eliminate the Government of India *Silver rupee notes* which would form the bulk of circulating notes in the initial days of the R. Bank regime.

Consolidation of the two departments.

The second needed reform is the consolidation of the two departments and the consolidated bank return should be as follows:

Liabilities.	*Assets.*
1. Shareholders' Capital	1. Govt. of India Rupee Securities.
2. Reserve Fund	2. Other Investments
3. Government Deposits	3. Sterling Securities
4. Bankers' Deposits	4. Silver Rupee Coin
5. Other Deposits	5. Subsidiary Coin

[16] See my paper "Some Salient Lessons from the Foreign Banking Systems, quoted in my book., Banks and the Money Market, p. 186.

Liabilities—contd.		*Assets—contd.*	
6. Bank notes in circulation		6. Gold coin and bullion (a) Held in India (b) Held outside India	
7. Government of India notes in circulation.		7. Internal bills of exchange and other commercial paper.	
8. Other liabilities		8. External bills	
9. Bills payable		9. Govt. of India Treasury bills.	
TOTAL		10. Balance held abroad (a) Advances with the B. of I. S. (b) Advance with the B. of England. (c) Advances with other C. Banks.	
		11. Loans and advances to Govt.	
		12. Other loans and advances.	
		13. Other assets	
		TOTAL	

The ratio of total gold coin and bullion and sterling securities as against liabilities of circulating bank notes and Government of India notes should be mentioned.

The Macmillan Committee pleads for " the restoration of a combined return so that the disassociation of the note-issue from the gold reserve takes place." The much-needed economising of gold can indeed take place only when this reform becomes a matter of fact. The long-distance monetary policy of the nation would seriously

consider the restoration of the gold standard.[17] Any rigid proportional reserve, however low it might be, would have to be still further reduced in consonance with the declining world gold output.[18] Hence an indispensable minimum of 40 crores of gold reserve which has been suggested might be approved if only the Indian people do not lose confidence or faith in the stability of the system. But it must be admitted that it is too radical a departure for the present-day policy of keeping a high metallic reserve as is evidenced by the P. C. Reserve regulations. Again there are no gold certificates circulating in the hands of the people acting as a buffer to lessen the repercussions of internal gold drain. The recent gold exports have not denuded the country of their gold stock entirely. They might still continue for some time to come.

Holding of Government Securities.

The success or otherwise of the "open market operations" depends on the holding of sufficient quantity of Government securities of both kinds, *viz.*, short-dated and long-dated nature. One kind of "open market operations" consists of not varying the volume of credit in the hands of commercial banks but the nature of securities is changed. The substitution of Treasury bills for long-dated securities and *vice versa* is needed to control their credit operations. This changing of the form of assets may be necessary to offset movements of gold by buying and selling securities. If the market rate of discount is to closely follow the official bank rate this kind of open market operation is needed. At the time of busy season the hundi rate tends to be governed by the Imperial Bank hundi rates. In other cases the hundi rate is very low depending more on shroff's supply

[17] Since these lines have been written the monetary gold stock of the world is expanding as a result of increased gold mining, the C. B. regulations permitting the mobilisation of hoarded gold and the return of hoarded gold from the Eastern countries. See my article "America's Abandonment of the Gold Standard" However the private gold stocks are being exported out of the country Until the monetary gold stock is high in view of attenuated private gold stock confidence will not be restored.

[18] See the recommendations of the International Chamber of Commerce, Paris, 1931 Sittings. The memorandum submitted by Professor Dr. T. E. Gregory on the immediate necessity of restoring the gold standard.

of money than anything else. It is natural that securities should be of different periods of maturity ranging from one year to ten years and even after that period. As these vary in time length the total amount of liquidating securities varies, thus adding to the mobility of the assets of the C. R Bank. While it is essential to fix " ten years' limit " to that of *securities of quasi-governmental authorities* for their credit standing might be seriously jeopardised in the long run *there is no necessity to fix the time* limit to the securities of the Government of India to be held by the bank.

The regulation of the securities of the Banking department is indeed a wise feature as it makes the R. Bank aware of its important rediscounting duties. An excess holding of Government securities would be leading to *safety* at the expense *of liquidity*. Mobile resources mean the necessity to have constant turnover and " bills and advances " item would be expanding thereby. It is laid down that total value of securities in the banking department shall not exceed the aggregate amount of the share capital of the bank, the reserve fund and 3/5 of the liabilities of the banking department in respect of deposits. The value of securities *maturing after one year* shall not exceed the aggregate amount of the share capital of the bank, the reserve fund and 2/5 of the liabilities of the banking department in respect of deposits. Same securities maturing after ten years shall not exceed the aggregate amount of the share capital of the bank and the reserve fund and 1/5 of the liabilities of the banking department in respect of deposits.

Importance of Sterling resources.

As our external liabilties can be paid through the London money market the sterling resources ought to be given equally great importance. It is the combined monetary gold holdings and sterling balances, *viz.*, Exchange and sterling securities [19] which ought to be reckoned under this heading.

The duty of supporting exchange has fallen on the shoulders of the Government. Adequate remittance for genuine foreign exchange

[19] But too large a holding of these and possible depreciation of them as in 1920 might mean possible loss to us.

requirements, both private as well as public, is now being provided by the Government's maintaining an exchange standard. The R. Bank has to maintain a continuation of this policy. Though direct dealings in foreign exchange on its own account are to be vetoed from the standpoint of banking theory, the duty of undertaking foreign exchange devices [20] falls on its shoulders so that the rates of exchange are controlled within tolerably assured limits. Such foreign exchange devices are sales and purchases of foreign exchange dealings in forward exchange and variations in the bank's buying price of gold. If a normal export surplus were to be realised exchange complications might not arise at all. It is imperative to say that this cannot be secured in these days of economic depression. Although the hoarded gold might be considered as an article of export to fill the gap in trade balance arising out of diminishing commodity exports the export of gold does not arise till higher value is available for it outside India.[21] But the possibility of non-monetary gold coming to our rescue should not be forgotten by the C. R. Bank.

The Silver Rupee holding.

A change in the front is noticeable. The Government of India which has been selling 155 millions fine ounces of silver since 1927 pursuant to the recommendations of the Hilton-Young Commission has been asked to pursue a different policy. Formerly in the 1928 R. Bank bill the silver redemption business was seriously thought of. Even the Reserve Bank has to facilitate this business of "dethroning" the silver rupee. The recent scheme for disposing of surplus silver has to be understood in this connection. 50 crores of rupees would be handed over to the R. Bank. The rest of the silver stock amounts to 5,541 lakhs. The Silver Redemption Reserve Fund against this would be the G. S. Reserve of 5,333 lakhs. The Silver Redemption Reserve Fund would have a debt of 208 lakhs. The existing loss of 3,163 lakhs on the sale of silver has to be added to 208 lakhs. So the total debt

20 Even the "rationing" of exchange and "pegging" of exchange form lawful devices.

21 See my article on "The Export of Gold" in the Mysore Economic Journal April, 1932.

against silver is 3,371 lakhs. Any Silver rupees returned by the Reserve Bank would be added to this debt against silver. Interest has to be paid on this from the Government revenues, while the Silver Redemption Reserve has to be invested in gold and sterling securities. The amortisation of this silver debt would be a part of the Sinking Fund Account. Funds accumulating in the Redemption Reserve should amount to 10 crores. Further receipts should be taken direct into Treasury balance to reduce the silver debt. A reserve of 10 crores in external assets means that provision is made to pay for the return of 25 crores which may be made within a period of five years. Any gold or external assets not handed over to the R. Bank would be added to the opening balance of the Silver Redemption Reserve. The principle is that the R. Bank should not be held responsible for the previous rupees issued by the Government of India. That the R. Bank should have been freed from the responsibility of silver rupee Redemption is but common justice. Section 36, Clause 2, makes it incumbent on the Government of India to provide any deficiency in the stock of silver rupees, *i.e.*, if they are less than 50 crores or 16th of the total amount of the assets against payment of legal tender value. In as much as this duty of providing silver rests on the Government of India the policy of selling silver is criticised by some of the economists.

Suspension of assets.

The possible suspension of asset requirements on the part of the R. Bank has also been arranged for. The gold cover requirements can be suspended in the first instance for a period of one month and this period might be extended to another fortnight. The bank has to pay a tax during this period upon the amount which has fallen below the legal minimum. This tax is to be one per cent. higher than the existing bank rate. But if the C. Reserve were to dwindle from $32\frac{1}{2}\%$ to a lower proportion it would be raised to $1\frac{1}{2}\%$ and in respect of every further decrease of two and a half per cent. or part of two and a half per cent. or part of such decrease. No tax need however be paid when the bank rate is below six per cent. per annum. The much needed increase in the matter of note-issue is thereby secured. Adequate provision for prompt return of issued notes has not been made on

the lines which the F. R. Board adopted in the matter of its note-issue.[22]

Relation with other banks.

The creation of the Reserve Bank would mean that the different banking units in the country would have to be arranged as follows and a policy of detailed co-ordination with C. R. Banking policy should be inaugurated on lines described below :—

(*a*) The Reserve Bank.

(*b*) The Imperial Bank of India separately incorporated under Act, 1920 (XLVII).

(*c*) The Indian jt. st. banks incorporated under the Indian Companies Act.

(*d*) The uncontrolled small proprietary partnership form of indigenous bankers whose number is indeed legion.

(*e*) The foreign exchange banks who are free to enter and open business in any port or even inland centre.

(*f*) The newly created co-operative credit institutions dealing with short-term or long-term credit.

(*g*) Other quasi-financial institutions as finance companies and insurance concerns which mobilise savings and tend to invest the same for special purposes.

The Reserve Bank is the crowning edifice of the financial structure of the country and other financial institutions belonging either to the call money-market or short-term money-market—(the money market itself dealing with short-term credits) and the capital market dealing with long-term capital requirements of the nation. It needs no emphasis to state that the R. Bank is the pivot of the money market which itself is composed of call money, the bill market, the short-term credit or loan market. The necessary co-ordination between these markets is to be secured by the official bank rate or price or rate of interest at which C. Banking credit or bankers' cash is obtainable. The rates prevailing in the money market can indeed influence the rates prevailing in the capital market. The duty of a wise central bank is not only to equate the demand and supply for money and credit in the money

[22] See my Essay " Some Salient Lessons from Foreign Banking Systems," p. 186, in my book entitled " Banks and the Money Market."

market of which it is the immediate custodian, but it must tend to equate the volume of national savings to investment demand existing in the country. The general banking and monetary policy of the C. R. Bank should pay heed to the problems arising out of the needs of member banks and financial institutions. It has to manage state finances and a policy of credit control has to be attempted which makes monetary policy subserve the needs of a given economic activity and system of the country. The second important part of the C Banking policy consists of the task of adopting the banking system as a whole to the requirements of world economy. The two aspects of banking analysis, *viz.* internal R. Banking policy and external R. Banking policy have to be studied apart. Attention will be paid to internal R. Banking policy.

Sole agent.

A Reserve Bank has to pay equal attention to the demands of all sound financial institutions and commercial banks conducting banking business in the money market. The granting of preferential terms to any one individual bank would vitiate this tendency. The appointment of the Imperial Bank as the *sole agent* of the Reserve Bank would lead to this situation. Apart from state-subsidised competition which will ensue as a result of Government Treasury Account being placed in Imperial Bank's hands alone, the freeing of the restrictions would make it a "redoubtable competitor."[23] The interest-free deposits which have to be maintained in the hands of the I. B. of India for maintaining the existing number of branches intact can be tabulated in the following way :—

(*a*) During the *first five* years *nine lakhs* of Rupees.
(*b*) During the *next five* years *six lakhs* per annum.
(*c*) During the *next five* years *four lakhs* per annum.

[23] The Reserve Bank pays the Imperial Bank of India the following remuneration during the first 10 years : a commission of 1/16 of one per cent. on the first 250 crores and 1/32 of one per cent. on the total of the receipts and disbursements of Government account on behalf of the Reserve Bank of India. At the end of 10 years this commission will be fixed *at* or *on the basis of actual cost* to the Imperial Bank of India. This revision will take place once in every five years and expert accounting will be employed so long as this agreement is in force (*vide* the 3rd Schedule, The Reserve Bank Act of 1934).

Branch Expansion.

Some of the sound joint-stock bankers openly insinuate that the Imperial Bank of India will be " the master of the banking situation," and will dictate terms to the indigenous banks. Such a situation might not arise for the Imperial Bank will not have to pay current accounts even as is the case with the other indigenous banks. Secondly, its position has to be absolutely liquid for the Government funds might be withdrawn at any time. This account is the most unsteady and most exacting one from the viewpoint of banking safety. This yearning for state deposits which are not of a " lying character " is indeed a weak point in the armoury of our joint-stock bankers.[24] But so long as state aid is definitely granted for branch extension or " branch maintenance business " as has been the case with the I. B. of India the joint-stock banks will certainly continue to agitate for this account.

Indigenous Banks.

No provision has indeed been made for the inclusion of indigenous bankers in the scheduled bankers' list.[25] That in course of time they would be included can be understood if one were to notice that the Report of the R. Bank might be recommending its extension of rediscounting privilege to indigenous bankers at the end of the three-year period. It leads to a concentrated reserve. Mobile and elastic reserves will tend to ease the loaning tendency on the part of banks. Credit can be made elastic and an effective credit policy can be secured.

The exchange banks have been rightly exempted from the publication of weekly information and they have to issue monthly the necessary data concerning their Indian demand and time liabilities,

[24] My suggestion for adopting the " tender system " in selecting agents to the Reserve Bank has indeed been negatived on the plea that the Imperial Bank can underquote the competing rivals. But the placing of interest-free deposits in the hands of the scheduled indigenous banks has to be considered by the Finance Member of the Government of India whenever these are conducting business of a quasi-public nature such as extension of facilities in places where they do not exist.

[25] This is left to the Central Board which has to decide when indigenous bankers can be developed as scheduled bankers,

their holdings of Government of India Currency Notes and R. Bank notes, their holdings of rupee coin and subsidiary coin, their advances item and bills discounted in India and their Indian cash balances. All the 19 Exchange Banks are included within the scheduled Bankers' list which includes those Indian joint-stock banks whose paid-up capital and reserve is never less than 5 lakhs of Rupees. They have all the quadruple advantages in their favour, *i.e.*, deposits and discounts both *at home* and in this *country*. The maintenance of this *status quo* and the creation of the R. Bank means the conferring of maximum advantages on foreign banks. If the London branch of the C. R. Bank is to be permitted to deposit its funds in the banks of the United Kingdom it might be that a portion of its exchange funds might be deposited in the Anglo-Eastern banks having their head office in London. Such a situation would make the development of the I. Overseas Bank an impossible contingency in the near future. The day is not far distant when we shall be surprised to find that the F. Exchange banks would be consistent supporters and coadjutors of the R. Bank in the Indian as well as the London money markets.

Apart from considering the fitness of few co-operative *urban* banks and Central *Banks* to secure quasi-public accounts, the appointing of them as agents of the C. R. Bank in places where the Imperial Bank of India is not represented might be deemed advisable just to inspire confidence in their ability. Always subject to the principle that " undue scattering of Government balances " should not take place the selecting of the financially sound Central Banks of the co-operative movement to receive interest-free deposits might be done.

The agricultural bills or promissory notes of the co-operative societies endorsed by the P. Co-operative Banks would have to be discounted by the R. Bank. Co-operative finance may be easily helped by six-months loans or the discount of nine-months bills. Free remittance facilities which the Imperial Bank used to allow have to be continued. That a particular limit to the volume of agricultural bills which can be purchased by the R. Bank should be made was the universal expectation but it has been omitted from the Act itself. The mere starting of the Agricultural Credit Department would not go far and in the absence of such a provision as the one mentioned above agricultural short-term finance might be seriously neglected. Sir Basil Blackett's suggestion that some of our scheduled banks and co-operative banks

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may be exempted from making any reserve-deposit as is the case with other scheduled banks may be carried out.

Warehoused goods have not been considered good enough,[27] for operating as collateral security and if the R. Bank's warehouses or licensed warehouses were to develop this business of perfecting of agricultural marketing would also take place besides the one of securing cheap agricultural finance. Licensed warehousing may tend to popularise the bill habit and create the bill market in this country. It must of course be recognised that a well-developed internal bill market would take several decades to get itself established. Warehousing would tend to increase the contact between banks and industry and trade.

The proper supervision of the L. Mortgage Banks and the floating of debentures on their behalf can be undertaken by this department. Instead of starting a Central Mortgage Bank for the country it has to control the mortgage banking business through the specially trained officers of the Agricultural Credit Department. But it involves a radical departure from the existing policy of small individual Land Mortgage Banks which are tackling the long-term agricultural indebtedness problem. Instead of an all-India Apex Co operative Bank as suggested by Mr. Darling, the R. Bank can successfully function on similar lines with great advantage to the country provided the Agricultural Credit Department is there. It can borrow from the International Agricultural Mortgage Credit company which is to be started by the League of Nations. As yet nothing has been done to implement the above proposal made by the League of Nations.

Rural finance can also be effectively helped by loans granted to pure shroffs and the pure indigenous bankers in the busy season. Certain of these can be appointed as agents of the R. Bank in places where the branches of the Imperial Bank of India or any other Government depositary does not exist. The recognised method of strengthening financial units is amalgamation. The *merger* tendency has to be initiated in case of our small indigenous banking units. They will thereby become the agencies through which C. Banking credit can filter into the interior. They can easily develop the bill market for

[26] His speech in the Legislative Assembly, 10th July, 1927. But many Co-operative banks are not included in the Scheduled List, II.

[27] See Clause 17 (Section *d*).

their pooled credit would soon be doubled. Any bill endorsed by such indigenous banking concern would be easily discounted in the bill market or rediscounted at the C. R. Bank. They can afford to become a valuable nexus between the R. Bank and the rural borrowing units. Without establishing this link or nexus the present day *dual banking* system cannot be abolished. The modern Bazar Hundi rate can follow the bank rate only when the *modernised* indigenous banker is controlled by the bigger joint-stock banks who are in their turn controlled by the Central Banker. The task of modernising these indigenous bankers is the greatest duty and benefit which the R. Bank may confer on this country. Some of them might be converted into discount-specialising bill-brokers or investment specialising agencies. Some may develop into acceptance houses, developing acceptance business but this specialised working has to be done on neatly organised lines which are supervised respectively by the Discounting, Issuing and Accepting Associations working in close consultation with the C. R. Bank of the country. If the services of the indigenous bankers' associations of the different localities are enlisted these advantages would be forthcoming.

Necessary Safeguards.

The Legislative Assembly should have power to discuss proposals concerning currency and the monetary standard of the country. The Governor-General's previous sanction might mean a real danger. If India wants an honest gold bullion standard when London is bent on maintaining the managed paper sterling standard it would be impossible to achieve this.

The political interference of Whitehall can possibly negative the discussion of such schemes. The present vested interests are those of London High Finance and City interests which would try to continue their domination as before. There might be insidious influence in the nomination of directors and higher officers responsible for the day-to-day management of the bank.

An attempt would be made by agricultural interests through the representation of the co-operative societies to increase the volume of agricultural bills which can be discounted. Even if the 1/4 limit might be carried out in actual practice it might not be considered as

coming up to the limit desired by them. But any fixing of a particular limit is imposing rigid shackles in directions where flexibility ought to be the best endeavour.

There is some kind of " industrial financing but not industrial banking." An attempt would be made as in England to forge more desirable links between the banks and industries of the country. It is as a consolation to this agitation that the Bankers' Securities Trust and the Bankers' Industrial Development Company have been organised by the Bank of England. But nothing tangible has resulted out of these corporations. An attempt would be made by the prominent industrialists to secure a link between the R. Bank and Provincial industrial corporations which they wish to start in every industrial Province. Beyond the possibility of securing sound investment which runs parallel to the efforts of savings on the part of the community, direct provision of long-term capital is beyond the scope of the commercial banks or the R. Bank meant to act as an emergency financial institution. It is only by maintaining low interest rates for short-term period that long-term rates of interest can be lowered and influenced. Again the possibility of holding an even balance in the matter of home and foreign investment arising out of the advice of the R. Bank can be discerned. In addition to the establishing of a close contact by a system of consultation and co-operation the different banking organisations must always be brought within the purview of the C. R. Bank. Home investment as well as Foreign investment must be properly safeguarded. It is not only necessary to control domestic managing agents, issue houses and Investment Trusts but the floatation of any foreign loans must be done after due consultation with the C. R. Bank. Even in England the necessity to supervise excessive foreign lending is recognised by the Macmillan Committee. The lessons from the findings of the Committee are clear. In any modern centralised banking system the contact between the C. R. Bank and the money market should be " close and successful." Secondly the contact with the capital market should be " intimate."

Annual Report.

One salutary feature would be the annual reports surveying the evolutionary trend of banking features in this country. Apart from

the necessity of reporting on such problems as the modernisation of indigenous banking and the fusing of the R. Bank with agricultural financing machinery it should continue issuing summaries of useful banking statistics. A thoroughly organised statistical Department of the Reserve Bank should collect and publish the *true daily average* of the scheduled banks' cash reserves. The consolidated weekly or monthly summaries of scheduled returns would have to find a place therein.[28] Foreign balances and foreign liquid assets held by the banks should also be known to the Reserve bank.[29] All other details which enable the R. Bank to realise the present financial position of India *vis-a-vis* the rest of the world should be collected by the R. Bank. The general industrial and economic statistics should also be collected. Thorough co-operation with the general statistical service of the Government should be forthcoming.

Enforcement of Banking Legislation.

Elsewhere, I have pointed out the necessity of the rationale of banking legislation. A rational control of credit would become impossible if banking legislation is not strictly enforced in the direction of organisation and working of the other credit purveyors. Instead of separate Government office a control department of the R. Bank has to see that banking regulations in force are properly observed and that the interests of the depositors are safeguarded in every manner. The comprising of monthly financial statement and the issuing of an annual survey of operations of banks may be performed by this department.

Governor-General's Interference.

Section 153 of the Government of India Act, 1935, which would in no case be modified in the near future, says that the Governor-General will prevent the interference with the management of the

[28] A glance at the Macmillan Committee Report, would give one an idea of the details pp. 177-85.

[29] The Macmillan Committee insists on closer ties between the clearing banks and the Bank of England itself, pp. 155 61.

exchange and currency policy of the bank by refusing to move any amendment to the R. B. Act without his consent. Too much power is already vested in his hands in the selection of officers (Sec. 152, Clause 1) of the Government of India Act, 1935, in admitting people of other dominions of the Empire to have a stake in the capital holding of the R. Bank (Clause 4, Sec. 4), in taking up the undigested portion of the share capital issued to the public and reselling the same after the lapse of some time (Sec. 4, Clause 9), increasing or decreasing the share capitial of the R. Bank (Clause 1, Sec. 5) and the issuing of the new share capital, in the appointment of Government official directors and non-official directors (Sec. 52 of the Government of India Act, 1935), in fixing the remuneration for keeping the Government account (Sec. 45 of the R. B. Act), in fixing conditions and limitations under which the R. Bank can refund the value of torn or mutilated bank notes to their holders (Sec. 28 of the R. B. Act), in deciding *when* and *how* and *under what conditions* the C. Board has to be superseded for grave dereliction of its duties (Sec. 30 of the R. B. Act), in having the power to issue demand bills and notes under extraordinary circumstances (Sec. 31), in undertaking the obligation to supply additional silver rupees if wanted or to receive silver rupees from the R. Bank's excess stock (Sec. 36), in permitting the R. Bank to issue additional or emergency notes on payment of tax (Sec. 37), in penalising scheduled banks whenever they fail to keep the prescribed cash reserve deposited in the R. Bank against their demand and time liabilities (Clause 5, Sec. 42), in including new joint-stock banks in the scheduled list of bankers having the rediscounting privilege (Clause 9, Sec. 42), in revising the term of the agreement with the Imperial Bank when the latter undertakes to do agency work on behalf of the R. Bank (Clause 1, Sec. 45), in compulsorily forming the Reserve Fund of the R. Bank (Sec. 46) and in allocating the annual surplus between the shareholders (Sec. 47) and the Reserve Bank itself, in appointing the auditor-general to examine and report on accounts at any time, in publishing weekly statement of Banking operations in the Gazette of India (Sec. 51), in receiving and publishing the annual report of the R. Bank's operations (Sec. 43), in receiving 75% of surplus assets in the event of winding up of the Bank (Clause 2, Sec. 57) and consenting to the detailed bye-laws and regulations to be formulated

by the C. Board of the R. Bank (Sec. 58). So many of these powers are being concentrated in the hands of the Governor-General in Council and most of the members of the same are generally ignorant of banking, currency, finance and exchange requirements of the country. Even at the risk of tiresome repetition it must be admitted that the orderly carrying out of the monetary policy of the nation is the duty of the R. Bank but the laying out of the national monetary and banking policy lies in the hands of the central legislature of the country. The duty of *supervision* should rest in the hands of the Supervisory Banking Council or the present standing Finance Committee can be enlarged to undertake this duty. It is not the Governor-General who should interfere with the course of unsound management but it is the *suspensory veto* of the Government-nominated official director who ought to see that an *unsound policy does not arise at all.* The Supervisory Banking Committee can be depended upon to scrutinise and tender advice to the Board of Directors. Otherwise *a national banking policy can never be attained.* Nor can it be assumed that the Governor-General in Council will be free from political influence.[29a] Again the complete co ordination of the bank credit policies and Government financial policies should be secured and be the cornerstone of its actual working. The undertaking of financing public enterprises at time by R. B. credit has to be considered in the interests of comparative stabilisation of business, credit and purchasing power. The directors of the Reserve Bank should always bear in mind the advice of Governor Benjamin Strong of the F. R. Bank of N. York which says " never forget that the Bank was created to serve the Employer and the working man, the producer and the consumer, the importer and the exporter, the debtor and the creditor, all in the interests of the country as a whole."

Its daily routine.

The work of the Issue Department would consist in handling the gold reserve, sterling securities, rupee securities and the commercial

[29a] See the Minute of Dissent by Sir P. Thakurdas to the London Reserve Bank Committee,

collateral against which notes can be issued on the principle of the proportional reserve system. With the ideal of dispensing with the unduly large holdings of unstable or fluctuating silver rupees—the Reserve Bank would tend to unload them on the Silver Redemption Reserve and take back in lieu of the same either gold or sterling securities.

The Banking Department which would cover all other Departments except the Issue Department would look after its relations with the joint-stock banks, the Imperial Bank, the indigenous banks and the Indian immigrant banks, if any. The opening of branches might be facilitated by the depositing of interest-free Government deposits in certain select Indian joint-stock banks subject to certain maximum rates at which they might be lent. These depositary banks might conduct treasury work along with the Imperial Bank of India who would secure the bulk of this business. Until such a policy is pursued the entire length and breadth of this vast sub-continent cannot be covered by a network of banks or branches. Its statistical department ought to gather a complete inventory of economic facts and figures which will enable the managing or governing authorities to shape the credit-controlling powers with the view of achieving comparative stabilisation and the satisfactory maintenance of balances in the different economic activities of life such as production, consumption, distribution, savings and investment. *Its rural credit department* which has not been started as yet would have to facilitate the reorganisation of agricultural finance in all its aspects. Its savings department would look after the successful investment of the rural savings organised by the post offices. At present they are simply considered as part of the floating debt of the Government. An earmarking of reserve funds in the hands of the R. Bank and utilising them for local purposes such as constructing public works would create the needed confidence that the provinces are not drained of their resources without receiving any corresponding advantages. The *bullion* department might be entrusted with the task of buying and selling gold at the accepted figures Following the suggestions of Dr. L. J. A. Trip, Mr. Manu Subedar recommends that the F. R. Bank should secure the monopoly of importing gold bullion into the country. Both the writers tend to exaggerate the importance of gold reserve which after all is needed to

settle international obligations alone. Gold is not after all necessary as a backing for currency. Its supposed efficacy in checking inflation is purely illusory. If the C. Bank or the Legislature expands the currency real inflation would ensue. Power to vary the prices and gold in the event of an exchange crisis must be delegated to the Managing Board. Actuated with the ideal of securing free internal remittance as in the United Kingdom and providing the Secretary of State with needed sterling resources for making payment of our annual Home Charges, it ought to be a decisive power in the exchange market. The reinstatement of free transfer of funds from one bank to another in case of all its constituent member banks is long overdue.

Public Trust.

There is not ample evidence of the fact that the R. Bank is a "public trust" except that provision has been made to limit dividends up to 5% maximum and the ceding of the profits to the State according to the programme outlined in Clause 4.

This quality ought to be fittingly displayed by its contribution in the direction of facilitating land mortgage business and short-term agricultural financing by having a special department of its own to study agricultural credit in all its ramifications or by making contributions to the Debt Sinking Fund so that external indebtedness might be curtailed. The construction of R. Bank's own warehouses or helping licensed warehouses to be started in the interior can be undertaken. The earmarking of a portion of the Reserve banking business's surplus has to be done at the outset. Such a thing exists in the case of other national banks notably that of the Bank of France.

Initial Difficulties.

It would be folly to minimise the real dangers which the R. Bank would have to experience in the early days of its existence. The financial good that it can hope to render would not be very conspicuous from the very beginning. The immediate changes that it would bring about must be studied. Firstly, it would necessitate the transfer of note-issue powers at present exercised by the Government of India. Secondly, it would involve some cataclysmic changes in the rediscounting

of "hundis" or "manufactured bills" by the Controller of Currency. Thirdly, the lack of an organised discount market and the absence of the bill habit may be commented upon. Nextly, the demand for loans in an agricultural country would be inelastic and discount rates can never hope to exercise effective control over the situation. Again the exchange banks might not agree to curtail their dependence on the L. M. market either for rediscounting their bills or for investing their liquid resources in the short-term money market of London. Finally, the much expected stabilisation of prices and money conditions and business stability would not be forthcoming even though a judicious use of the bank rate or open market operations can be made.

Considering the "agricultural lag" fluctuating or changing price-levels would have more pronounced effect on the farmers than on the industrialists. However much the need for benefiting the farmer by means of a stable price-level might be felt, still in actual practice it cannot be realised without other helpful factors co-operating with the Central Bank in improving the situation.

If the above suggestions indicate the lines on which opposition to C. Banking measures can be expected it can still be pointed out that *the immediate benefit accruing* to the country can be experienced in the following ways.

With member banks' mobilised reserves in its hands, an elastic note-issue and a comparative price or business stabilisation discount policy actuating the working of the Reserve Bank—an open market operation policy to supplement it and with power to borrow abroad in the interests of the country the R Bank can secure the development of a bill market, make provision for rediscount facilities, facilitate the creation of rupee bills and lower the interest rates prevailing in the country.

Confining its activities as do most of the Central Banks of other countries to the indigenous members of the Indian money market it can act as a successful bankers' bank helping agriculture and industry, at the same time by discounting agricultural bills of nine months' duration and concentrating within its own hands the power of floating debentures for provincial apex land mortgage banks or provincial industrial corporations when they are created.

Nextly, the monopoly of the foreign exchange banks can be broken down by helping the competing local exchange banks. The

necessity of selling to or purchasing sterling exchange from any of its scheduled banks would reduce the present-day dependence of the Indian joint-stock banks on the foreign exchange banks. Again, it would prevent the recurrence of the 1913-15 banking crisis. Finally, even taking for granted that it operates in an orthodox manner the R. Bank would facilitate and improve the remittance business of the Government, provide the rediscount facilities for the commercial banks, manage the currency and the credit system of the country and perform treasury business on strictly intelligent principles. The most important innovation would be the rediscounting of hundis by the joint-stock banks which is now considered a weak sign and not resorted to by them. This would enable the spread of the banking net far and wide. It would increase his scope to exercise his power over the entire banking field. The slow popularising of the credit instruments, the encouragement of the deposit habit, the training of men fit to run banking institutions and the efficient handling of the banking system during the times of a crisis, would be some of *the immediate beneficial advantages.* But to secure even these simple benefits it has to pursue a bold, active, forceful and energetic policy. Conducting its business in the above manner it will eventually occupy its rightful place in the Indian money market as the corner-stone of its currency and credit system.

For a realisation of the higher advantages of the C. R. Banking system it takes indeed longer time on the part of the Reserve Bank to accomplish any one of these advantages. As I have stated elsewhere,[30] the R. Banking policy should pursue a correct line of action in satisfying the currency and credit requirements of agriculture, industry, and commerce in times or periods of unemployment, in times of trade cycles, in periods of bouts of speculation, in days of unceasing gold movements, in times of increasing necessity of international Central Banking co-operation, and in securing business stabilisation and the satisfaction of the Government's financial requirements and capital expenditure. Complete co-ordination of bank credit policies and Government's financial policies should be

[30] Modern Central Reserve Banking Policy and its Ideals—" Lecture 4 " in the series entitled " Banks and the Money Market " delivered to the Institute of Bankers.

secured and be the corner-stone of its working. It needs no emphasis to state that our R. Bank would be unable to secure any of these desirable advantages at *the very outset.* Better organisation and closer touch with the money market may enable it to realise this desirable and ambitious programme of economic Swaraj, monetary rationalisation, widespread and organised banking development, stabilisation of monetary markets, and effective control over credit.

Long-period Advantages.

In the evolution of time when present-day difficulties concerning war debts, lack of international understanding, tariffs and armament tend to disappear the world might decide to adopt a definite monetary system. The present-day linking of the country to the sterling standard [31] might be given up and a permanent monetary system might be adopted at the suggestion of the R. Bank. The temporary depreciation consequent to the linking of the rupee with sterling has produced no lasting benefit. In spite of insistent cries for a managed currency policy aiming at improved internal prices secured through a policy of economic autarchy the Indian Government have been marking time. So long as Great Britain refuses to adopt the resurrected gold standard the chances are indeed remote for this country to give up the rupee-sterling link. Lowered interest rates and balanced budgets, thanks mainly to higher taxation yields and improved industrial situation resulting out of enhanced customs duties and increased savings deposits, strengthening an otherwise weakening exchange, stationary price-level, slightly increasing exports and continued export of gold are indeed some promising signs of economic relief but unless the R. Bank consciously and deliberately plans the entire currency system of the country *in the light of the* producers' and businessmen's requirements no real material progress can be achieved by this country. To achieve this purpose it is essential for the R. Bank to study India's needs. Indian needs first, Indian needs second and Indian needs third

[31] For the pros and cons of the step, see my articles "India—the Gold Standard and the Crisis" and "India and the New Sterling Standard."

ought to be the ideal. To be dragged after the chariot wheel of the Bank of England and be dictated by the exigencies of the British Treasury seems indeed derogatory to the dignity of the country. Such a policy would never enable the realisation of the national economic interests in monetary and banking affairs. Monetary nationalism is indeed the most crying need of the hour.

The evolutionary trend of momentary management in modern times has been in the direction of controlling credit policy and adjusting the supply of currency to the volume of credit created. The management and general direction of credit is being done in the wider economic interests of the country. This managed system of credit and currency must pay heed to national considerations and internal requirements alone. Regard to international complications ought not to sway the above policy. The dictating of the credit policy of the banking world as a whole is surely beyond the scope of our R. Bank. Securing comparative stabilisation of internal prices it ought to be the endeavour of the R. Bank to confer short-term stability of exchange so that traders might not be inconvenienced. At the present stage of statistical knowledge it is impossible to determine exactly how much credit and money would be required and produce that much alone—no more and no less.

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CHAPTER IV

The Foreign Exchange Banks

The official definition—Two groups—Statistical tables—Explanation of their business—Nature of their business—Foreign exchange explained—Their defects—Quotations of Exchange rates—Their meritorious services—War-time services—"Forward exchange operations"—General aids to their business—Their wide margin—Vested interests—Commercial Banks undertaking foreign exchange—Suggestions to overcome their difficulties—Dealings in future-conditions of safety—Suggested restrictions against the exchange banks—General objections—Possibility of evasion—An examination of the restrictions—Terms of the License—The real remedy—An unpardonable exaggeration—Statistical Tables denoting their progress.

The official definition.

The official definition of the term "Exchange Banks" points out that the head office of the banks should be outside India. But in Western countries this word is used as a general term to include those banks "that are specially concerned with financing the trade of India and China which countries not having a gold standard have exchanges peculiarly liable to fluctuation."[1] The fact that the Presidency Banks were not allowed to deal in foreign exchange business gave scope for these banks to specialise in it.[2] No rigid partition of business exists between those major types of banks doing business in India, *viz* , the Imperial Bank, the exchange banks and the Indian joint-stock banks. The exchange banks besides dealing in foreign exchange conduct ordinary banking business, *i.e.*, they lend money at call, make investments, grant loans, issue commercial and travellers' letter of credit, receive deposit and do agency business but during the busy season they invest a considerable portion of their

[1] See Dr. L. M. Minty, "English Banking Methods," pp. 44 and 45.

[2] Although Cooke, Brunyate and Symes Scutt point out that this limitation was a self-imposed one on the part of the Presidency Bank of Bengal and the later researches of this period have faithfully copied this information, *still the name of the director who imposed this limitation is not given out in any book on this subject as yet. It was Mr. Cockerel who unconsciously added the words "payable in India," etc., and thus imposed this limitation.* See the Asiatic Journal which quotes it from the *Bengal Courier*, June 12, 1838.

funds in discounting foreign trade bills. It is this special feature that differentiates the exchange banks from the other banking institutions of this country. The financing of the foreign trade of India is practically in their hands. But some of them find internal banking business more paying than the foreign exchange banking business. Manu Subedar says "that the amount of funds devoted by exchange banks for financing internal trade is as great as that of the Imperial Bank and the Indian jt.-st. banks."

Two Groups.

The exchange banks fall into two groups, *i.e.*, Group I:—Banks whose business in India is limited and forms, say, one-tenth or even less of the total volume of their business. In recent years they have been holding only 1 % of their total deposits and 1% of their cash reserve in India. The following banks belong to this category:—

Name of the Bank.	Head Office.	Year of establishment in India.
1. The Comptoir National D'Escompte de Paris.	Paris	1862
2. The Yokohama Specie Bank.[3]	Tokio	
3. The Sumitomo Bank	Osaka (Japan)	Bombay (Dec., 1916)
4. The Bank of Taiwan [4]	Taipeh (Formosa)	Bombay, 1917 Calcutta, 1921
5. The Mitsui Bank	Tokio	Bombay, 1924
6. The Kanan Bank	Tokio	Rangoon

[3] The Indian branches of the Yokohama Specie Bank were opened at Bombay in December, 1894, at Calcutta in October, 1911, at Rangoon in January, 1918, and at Karachi in July, 1925.

[4] The Bank of Taiwan was temporarily closed in the spring of 1927 as it locked up its money in advances to the *Suzuki* concern. The Japanese Government authorised the Bank of Japan to grant advances to the Bank of Taiwan and from May 9, 1927, it began conducting business as usual.

Name of the Bank.	Head Office.	Year of establishment in India.
7. The International Banking Corporation (absorbed by the National City Bank of N. York)[5]	New York	1903
8. Netherlandsche Indische Handles Bank [6] (Netherlands India Commercial Bank)	Holland	1863
9. Nederlandsche Handal Maatschappij [7] (Netherlands trading Society)	Holland	1889-Rangoon 1920-Bombay Calcutta.
10. Hongkong-Shanghai Banking Corporation[8]	Hongkong	1867
11. American Express Company (absorbed by the National City Bank of New York).	New York	
12. Banco National Ultramarino-	Lisbon	Bombay

[5] This Bank is the offshoot of the National City Bank of New York. The present name was adopted in 1921. It has branches in Bombay, Calcutta and Rangoon.

[6] This was started in 1863 as a private bank and began extensiveplantation business in Java and the Dutch East Indies. In 1884 it had to shed its plantation business and due to prompt help from the Netherlands Trading Society it did not fail. See E. Labarre's Abridged English Edition of the History of the Netherlands Trading Society—published in 1924, pp. 48, 50.

[7] The Netherlands Trading Society was formed by King William I in 1824 with the object of promoting national trade, shipping, fisheries, agriculture, factories and transport and open up new avenues for Dutch commerce. It soon became the banker to the Government. By 1874 it began to combine banking business with trade in goods. From 1890 it began conducting increasing volume of exchange and banking business in the East Indies. In 1889 the first Indian office was opened at Rangoon and it was confined to local credit business. In 1920 branches were opened at Calcutta and Bombay. From a mere trading concern it became a successful banking corporation in the widest sense of the term. The most distinguishing features of the concern were its many-sideda ctivities in the direction of plantation and forming syndicates for constructing railways. See *ibid.*

[8] It has an important office and Committee in London.

Name of the Bank.	Head Office.	Year of establishment in India.
13. The Imperial Bank of Persia [9]	Teheran	Bombay
14. Lloyds Bank amalgamated with Cox and Co., and H. S. King and Co. [10]	London	1923
15. Thomas Cook and Sons Bankers.	London	
16. The National Bank of South Africa.	Cape Town	Bombay

The Russo-Asiatic Bank and the Deutsche Asiatische Bank have closed their doors since the outbreak of the last War. Besides the first three Japanese banks which are generally mentioned by the other writers on banking there are two more Japanese banks having branches in India. The Mitsui Bank has a branch at Bombay opened in 1924, and the Canan Bank has a branch at Rangoon. Some of the banks of this division are generally styled "Agency Banks" as they specialise in managing the financial needs of the tourists, British and foreign residents in India. Thomas Cook and Sons, Grindlays, the American Express Company and the Lloyd's can be taken as the chief Agency Banks in this country.

Passing on to *Group II* the exchange banks that belong to this category are the following. Though their head effice is situated outside India they have their major portion of business conducted mainly *in India.*

Name of the Bank.	Head Office.	Year of establishment in India.
1. The Charted Bank of India, Australia & China [11]	London	1853
2. The National Bank of India	London	1863

[9] It has decided to wind up its Indian business and has appointed the Lloyd's Bank as its Indian Agent (Aug., 1934)

[10] This amalgamation was brought about in 1923.

[11] This bank does no business in Australia. Owing to the hostility of the Press in Sydney it had to give up its attempts of opening an office in Australia. It is not difficult to divine the reason. In October, 1927, it secured control over the P. and O. Banking Corporation as 51 per cent. of the shareholders sold their shares to the Chartered Bank of India and from January, 1928, this bank merger is conducting its business.

Name of the Bank.	Head Office.	Year of establishment in India.
3. The Mercantile Bank of India.[12]	London	1893
4. The Eastern Bank of India.	London	1910
5. The P. and O. Banking Corporation.[13]	London	1921

The newly started Imperial Bank of India does exchange business for its customers only. The Alliance [14] and the Tata Industrial Bank [15] did exchange business on a large scale. One or two Indian banks have recently been started in Bombay to deal with exchange business. Both the foreign firms—Thomas Cook and Sons and Grindlay and Company [17]—conduct exchange banking on a large scale but it is

[12] It transacts a large volume of business in South Africa and British Africa. It originated in India in 1863 but was transferred to London in 1836 after adopting the present name.

[13] In 1921 the P. and O. Banking Corporation affiliated itself with the Allahabad Bank. Owing to the recent merger of the Chartered Bank with the P. and O. Banking Corporation the affiliated banking combination would have about 89 branches in all. While speaking of this transaction it is essential to know the nature and object of this fusion. "About 196,059 shares in the P. & O Banking Corporation were acquired so as to secure a controlling interest in the P. and O. Bank. We regain control of valuable business connections which had rather passed away when the P. and O. Bank came into existence, such business covering India, Burma and Ceylon, China and Japan and so as to prevent the business from getting into other hands. Further we have a well-established business working in harmony with ourselves and ceasing to function as active opponents. To make effective our control of the Bank Mr. W. E. Preston has become the Vice-Chairman of the P. & O. Bank and Messrs. Bateson, Colin, Campbell and Mackay have joined the Board of Directorate of the P. & O. Bank." See the Chairman's speech on the 24th ordinary general meeting of the Chartered Bank. This practice of large banks affiliating other banks to themselves by the purchase of shares is not common in Indian banking circles. This practice arose during the War and in the L. M. Market there are several big joint-stock banks holding the shares of smaller ones conducting business in Scotland and Ireland.

[14] The Alliance Bank of Simla failed in 1924.

[15] The Tata Industrial Bank recently amalgamated with the Central Bank of India.

[16] The Union Bank of Bombay and the Industrial and Exchange Bank. Of these, the first bank is now under the management of the C. B. of India and in the near future there may be a complete amalgamation. The Industrial and Exchange Bank has suspended payment.

[17]. Messrs. Grindlay and Co., is affiliated to the National Provincial Bank—one of the 'Big Five' of the London joint-stock banks.

ancillary to other work they undertake. There are several other houses which conduct some banking business and their establishments in London as well as in India give them an opportunity to conduct exchange banking on a small scale. Some of the interior joint-stock banks have correspondents in London and other financial centres of the world. Sometimes they do exchange business on their own account but very generally they keep only working balances to supply exchange facilities for their customers. They buy and sell and receive for collection drafts and telegraphic transfers' grant commercial credits, buy approved outward bills, issue travellers, letters of credit available in all places of the world. They secure local deposits, discount bills and lend on shipping and other documents.[18]

Statistical Tables.

	No. of Banks.	Paid up Capital (£1,000)	Reserve (£1,000)	Deposits In India (Rs 1,000)	Deposits Out of India (£1,000)	Cash Balance In India (Rs. 1,000)	Cash Balance Out of India (Rs. 1,000)
Group I	14	64,586	53,689	199,714	847,957	29,189	1,11,407
Group II	5	9,644	10,382	505,743	75,604	64,972	11,351

Explanation of their Exchange Business.

The position of the Exchange Banks in our banking system is essentially two-sided. On the one hand they perform their business in India and on the other they conduct banking business in the country of their origin. The Eastern Exchange Banks pay slightly higher rate for deposits than what the London jt.-st. banks pay. Their usual deposit rate however is two per cent. on current account provided they do not fall below a stipulated minimum. In India they pay a slightly lower rate than that of the Indian joint-stock banks but their

18 This table relates to the business of the Exchange Banks during 1925. The Banks in Group I are 13 and figures relating to the National Bank of South Africa are not included. See the 12th Issue of Statistical Tables relating to Banks in India, p. 15. For more recent information see Commercial Banks (1925-33). The League of Nations Publication, 1934, p. 320.

rates are more favourable than the Imperial Bank's rate for fixed deposits or the rates granted by the English joint-stock banks in London. The Imperial Bank does not now pay on current accounts while the exchange banks pay 2% on balances exceeding a definite limit.

Formerly they used to take pride in the fact that they obtained capital for India from London but now they have discovered that money can be tapped in India also. J. M. Keynes pointed out long ago that these exchange banks never kept an appreciable cash reserve in India but their position has been much strengthened ever since that time. But, of late, it has again fallen to a low figure as denoted in the following table.

Percentage of cash to liabilities on 31st December each year.

	1916.	1925.	1928.	1930.	1932.	1934.
Group I. Agencies of large banks doing business in India.	35	15	11	8	15	13
Group II. Banks doing considerable business in India.	25	13	11	13	12	10

The chief difficulty of the exchange banks consists in their undertaking to perform their business in several places. They have to so carefully adjust their resources that they do not suffer from want of capital at any place and this is no easy task. Their position would be very difficult if a concurrent crisis both in the London money market and India were to develop simultaneously. Normally, they depend on importing funds from London to India and remit it back after the period of employment. So long as they have sterling assets to cover their liabilities in other currencies there is no danger. A sterling bill can easily be sold in the highly organised discount market of London and the proceeds are always equal to gold in a free gold market as London. So long as sterling is convertible into gold it has to be considered as a safe cover for a liability in any other gold standard currency.[19] Danger arises only when the sterling is not convertible into

19 See paras. 50 and 37 of the Bengal and Bombay Provincial Banking Committee reports.

The chairman of the Mercantile Bank of India (1929) plainly admits that local business compensates greatly any loss in foreign exchange business.

gold and at such a period the Exchange Banks should cover every such obligation with an asset payable in the *same* place and in the *same* currency.

The nature of their other business.

The exchange banks besides dealing in foreign exchange and buying export and import bills conduct ordinary banking business competing to a certain extent with the Imperial Bank and the Indian joint-stock banks in the matter of loans and overdrafts.[20] They finance internal trade in certain big centres of trade like Amritsar, Srinagar and Mandalay. The piece-goods trade in Delhi and Amritsar and the leather trade of Cawnpore are financed to a great extent by them. They compete with the Bengal branch of the Imperial Bank of India in the matter of financing jute operations. In the Madras Presidency they confine their business solely to the financing of export and import business but they practically do very little or hardly any local business for Indians. The Exchange Banks utilise the Mrwari bankers to a great extent and grant advances to them on security goods, produce or bills of exchange and fix exchange contracts with them from time to time. The Marwari banker considers it as his main duty to secure advances from the exchange banks and these finance the exports and imports to and from the interior of the country to the ports. The Exchange Banks have about sixty to eighty branches in the interior of the country and there is no statutory restriction compelling them to keep a high proportion of cash reserves in India against their Indian liabilities.[21] They deposit a part of their cash reserves in the Reserve Bank of India. They are some of the chief importers of gold bullion and sovereigns into the country. The gold bars of the two banks, *viz.*, the Chartered Bank and the National

[20] See p. 337. Majority Report for a table stating the proportion of cash to liabilities kept by the Exchange banks.

[21] The gold bars that are specially meant for India and the Far East are manufactured in London in quantities of 100 oz. and 500 oz. and the gold bars sold by the Bank of England are packed for export free of charge but the cost of the box including the packing is actually about 4*s*. Each bar weighs 400 ozs. and it is roughly worth about a little over £1,700.

Bank of India are the most popular. Their colour and touch are well-known and though the Central Bank of India is trying to import gold bars of 5 and 10 tolas each these have not succeeded in undermining the popularity of the above gold bars.[22] Silver is also imported by the Anglo-Eastern Banks.

Coming to their exchange business the export bills are classified as D/A (Documents on acceptance) and D/P (Documents on payment). They are bought *in* India and drawn *on* London and as they are drawn on well-known houses *in London*, they can be discounted easily. The head office of the bank in London holds the D/P bills till maturity and cashes them. The D/A bills are rediscounted immediately after acceptance at the London joint-stock banks or bill-brokers or the Bank of England according to the ease or tightness of the money market in London. A large majority of the export bills in Calcutta are sight bills and received by the bank in time to be despatched home by the weekly mail. Some of the export bills are usually drawn for three months. They are either 'clean' or 'documentary.' Whether the D/A bills will be immediately rediscounted or not depends on the following factors: the nature of the drawer of the bill, the Bank of England's rate of discount and the bank's own need for cash. The money to finance the export trade thus secured by means of rediscounting export bills is British capital and not Indian money.[23] This is considered a danger to our export trade. As the Indian deposits of the exchange banks increase this danger will be minimised. India's dependence on external capital is being slowly reduced and if the export surplus is always wisely invested or banked in the country reliance on external capital would not be necessary. During the last

22 The Bombay importer known as the "choksy" agrees to pay the price to the Exchange Bank on the arrival of silver and through the medium of shroffs; this silver is distributed to the up-country centres. In addition to these the Marwari broker-speculators ar also active dealers in the silver market The Bombay Silver Merchants' Association regulates the market. For detailed information, see B. White, "Silver, its History and Romance."

23 No accurate statistical information has been collected with the object of estimating the amount of funds employed in rediscounting the Indian Trade Bills. Some idea can be had if the amount of bills rediscounted by the exchange banks belonging to Group II is taken into account. It is true that they discount other countries' trade bills also but Indian trade bills form the major portion of their "bills discounted" item.

15 years there was a great development of the capital resources of the country and the Government during the last three years were able to finance large sterling expenditure on capital account apart from revenue account and paid small repayments of sterling liabilities, and the English stockholders of the G. I. P. Ry., were paid off to the extent of two or three millions sterling. Thus *absolute reliance* on external capital is no longer a feature of the present-day economic conditions as it used to be in the past. Again the Central Bank that would be started in the country would absorb much of the rediscount business in future ; hence it would be Indian money that would finance our trade. At present there is no difficulty in financing export bills and the exchange banks usually arrange adequate finance. Previously when the import cover was insufficient they used to generally depend on Council Bills for laying down funds in India. Even now no emergency currency is actually needed for this purpose of financing export bills.

The import bills are negotiated *in* London and drawn *on* India. Again it is the Exchange Banks that finance the import trade through their London office and its funds there. The bulk of the bills are drawn D/P (Documents on payment) in sterling. These bills are never rediscounted. This can be repaid at any time during their currency A large number of them become past due as the importers treat the due date of maturity with indifference. The result is that the payment for the bills is uncertain. The exchange banks finance the exports of British shippers by discounting their documentary bills of exchange and the shippers execute letters of request and hypothecation in favour of the Exchange Bank. The exchange banks become holders for value of bills drawn on the Indian consignees. The Indian consignees generally accept the bill and apply to the exchange banks for delivery of goods before payment against trust receipts. The bills of lading and other necessary documents are released. The Indian consignee thus obtains possession of the goods which he holds as the trustee on behalf of the exchange bank. The goods are now stored in a godown rented by the consignee and the bonded warehouses are often selected for this purpose. On selling the goods the consignee would be in a position to pay the bill.

Usually India has a favourable balance of trade which has to be paid to her and the exchange banks formerly used to liquidate the

balances by buying Council bills and Telegraphic Transfers.[24] They also sent gold bullion, coin and silver bullion. Besides these there was the transfer of Government Rupee paper from London to India, At present there is the sale of drafts required for Indian travellers and students in England. Thus the purchase of export bills is done with the aid of (1) import bills, (2) sale of sterling to the Government of India payable in London, (3) gold and silver bullion, (4) transfer of Rupee paper and (5) sale of drafts and telegraphic transfers payable in London and elsewhere out of India to private customers.[25]

The Eastern Exchange Banks are doing quite a lucrative business. The dividend that they declare is not only high but their shares possess a high value on the stock exchanges.[26] Thanks to the Gold-exchange standard system the speculative element in their business has been removed and a satisfactory ' par of exchange ' is established between the silver-using countries and the gold standard ones. They have passed through a keen struggle for existence. They have obtained great reputation consequent to their long-establishment in this country for a long time and they are zealous of intruders who may encroach on their business. It is the prevailing opinion that " it is practically impossible to start a new exchange bank in teeth of the opposition of the old ones." In 1870 there were only three exchange banks and in spite of the ' open-door policy ' maintained by the Government of India their number is exceedingly small. In 1919-21 about six exchange banks opened their business in India and their total number rose to 19. Their business is such that the customers flock to the old exchange banks rather than patronise the new ones.[27] As Mr. Wolfe observes, " the English Banks have subdivided the export field in business-like fashion, honey combing each section with branches, agencies and correspondents and through the undisputed sway which London has as the centre of financial transactions in

[24] The new system of Government purchases of sterling by public tender in India has displaced the old one of the sale of council bills.

[25] See the second table attached to this chapter.

[26] See the third table attached to this chapter.

[27] J. M. Keynes says, " Indian Exchange Banking is no business for speculative or enterprising outsiders and the large profits which it earns are protected by established and not easily assailable advantages."

international business are very well placed to serve their clients and English export trade cannot help but derive the utmost advantage therefrom."[28]

Foreign Exchange explained.

Foreign exchange business involves two sets of transactions. Firstly, it confines itself to the buying of exporters' bills of exchange drawn on the different markets of the world and the forwarding of these bills for acceptance and discount or for collection to their foreign correspondents or branches if they exist. By this method the exchange banks create credits in foreign centres where the bills are payable. Secondly, these funds have to be utilised and so demand drafts against these credits are sold to those people who have to make remittances. Profits from this business accrue out of a combination of purchase and sale of Bills (such credits) and the margin between his buying rate and selling rate constitutes his profits. The creation of excessive foreign credits which cannot be used means idle funds in a foreign place. If no sufficient foreign balance is to be had when the demand for bankers' bills is brisk, the opportunity for making profits is lost. Success in foreign exchange work depends on the buying of commercial bills just sufficient to meet his own drafts against the same centre. This business principle is often styled in banking parlance as the "rule of compensating purchases and sales," *i.e.*, maintaining an equilibrium between the addition to and subtraction from his foreign balance.

While the above principle affords the theoretical basis on which foreign exchange business is to be conducted there are occasions which tend to make them deviate from the principle. In case of speculation in foreign bills and investments in foreign bills there is a sacrifice of the principle of purchase and sale.[29] But when he is acting for the buyer or seller of bills of exchange the banker does not forget this cardinal principle.

[28] A. J. Wolfe, "Foreign Credit."

[29] If it is expected that sterling would rise in the future the exchange banker may buy more sterling futures than he sells, *i.e.*, he overbuys. Similarly, if he has reason to expect that sterling would fall in the near future he sells more sterling futures than he buys, *i.e.*, he oversells.

Broadly speaking, it is not the trade factor alone that is the sole force operating on the exchange market. There are other forces working on the foreign exchange market and if a final statement of these different forces is to be made this tabular form would be of much significance.

Debits to the Indian Exchange Banks.	Credits to the Indian Exchange Banks.
1. Merchandise Imports	1. Exports (Merchandise).
2. Indian tourists, students' remittances.	2 Re-export of precious metal from India.
3. Immigrant or banker and Insurance Co.'s remittance...	3. Missionaries, travellers, etc., and their payments to India.
4. Indian securities repurchased	4. Short term loans floated by Indian business firms or the bankers.
5. Gold and precious metals imported to this country.	

The supply of bills in the Indian exchange market arises out of the exportation of goods, out of the sale of Indian securities to foreign investors and out of payment of interest, etc., on the foreign securities owned by the Indian people and short-term loans floated by Indian business firms, the Government or the bankers. These create credits in London and other foreign centres for the Indian bankers.

Against the credits thus accumulated the bankers sell drafts to those who make a demand for them. Demand for bank drafts arises out of the importation of foreign goods, the services of bankers, etc., payment of interest, etc., by Indian borrowers to foreign investors, expenditure by Indian Government, tourists, students, etc., and repayment of short-term loans floated by Indian borrowers in London and foreign centres.

Thus the Exchange Banks receive all payments due to the Indian people by foreigners by taking up the bills of the " Indian creditors and advance money on the same or transfer it for collection. The Exchange Banks make payments to our creditors by receiving our

money and give us a bill payable abroad or present to us a bill payable drawn by the English or foreign seller. As our trade does not usually nicely balance sales and purchases are never equal or in equilibrium." It is the duty of the exchange banks to act as the middlemen reducing international trade to barter.

The expression rate of exchange means the terms upon which the bill payable in foreign money will be exchanged for rupees. There is no single rate to cover all varieties of bills drawn in foreign money. Due to variations in risk they command different prices. The rate of exchange refers to bankers' telegraphic transfer drawn upon the foreign country, *i.e.*, it represents the drawing rate for telegraphic transfers on foreign city. The price of the Bank bill depends on the intrinsic worth of the domestic money and the usefulness of funds in a foreign city versus the usefulness of funds at home. The rates are controlled by the forces of demand and supply of bills of exchange fluctuating in normal times within the narrow range fixed above and below the par by the cost of exporting and importing specie. The duty of the exchange broker is to multiply and perfect his means of gathering information regarding the sources of supply and demand so as to be able to predict what the behaviour of rates will be. Their tentative bids and offers of the exchange are approximations to the ideal rates at which demand and supply will be in equilibrium. The progress of the rupee rate is generally subject to the influence of several factors the most important of which are the following. The increasing progress of the export trade, the firm monetary condition, the paucity of imports and other means of remittances from India to London and the reluctance on the part of the Treasury to make substantial purchases of sterling tend to raise the rupee rate upward.

If the rupee becomes more valuable in sterling it means that the sterling demand for the rupee is strong. Sometimes present demand for the sterling is accompanied by sale of sterling for one or two or three months ahead. This means that some one having bought already sterling forward to cover his future needs has found it advisable to resell the same before the time comes for them to be delivered and to buy on the spot. This can only be done if the "spot price" were low and the future high. But the very fact that people are induced to buy "spot" when low and sell futures when

high tends to stabilise prices or rates of exchange. The lack of stable standard of payment renders necessary this provision of forward exchange.

Their defects.

The exchange banks have never perfected the means of remitting the favourable balance of account into the country. The Government by the sale of Council Bills and Reverse Councils have been "spoon-feeding" them at both ends with the consequent result that credit organisation has not been perfected in India. Sir Stanley Reed repeats the charge very eloquently before the Hilton-Young Commission—"*I hold the view rightly or wrongly that this practice of spoon-feeding the exchange banks has been demoralising to the exchange banks.* I think if the Exchange Banks instead of being able to sit and draw their remittances at convenience on tap, by putting the cup under the tap and taking what they wanted have been forced to consider ways and means of dealing with this remittance business, they might have gone much more actively into the Indian money market for the development of Indian resources or possibly—which was a point which was put before one of the earlier commissions—very strongly encouraged the purchase of sterling securities or securities abroad. In all these ways the Exchange Banks could have been more valuable to Indian finance and the development of Indian resources than they have been quite apart from the exchange operations themselves." [30] India could easily have been made a creditor country under their guidance. The purchase of international investment out of the available funds arising out of favourable balance of merchandise payments after paying all visible as well as invisible debits, could have been taught to the people. Even now it is not too late if they undertake to teach the people the art of investing the annually net favourable balance of accounts. Sir Dadiba Dalal wrote long ago that "we missed the favourable opportunity of acquiring foreign investments during the period of late war." [31]

[30] Volume V, p. 246.

[31] See his Minority Report—Babington Smith Committee—see also the oral evidence of Manu Subedar before the Babington Smith Committee.

The exchange banks always protested against the proposal that the Presidency Banks should be allowed to do exchange business and gain access to the London Money Market. Undoubtedly this was one of the main causes for dwarfing the stature of the old Presidency Banks. They were against the closing of the mints in 1892. They were against the formation of a Central Bank by means of amalgamating the old Presidency Banks or the starting of a State Bank, in order to perfect the organisation of Indian money market. They succeeded in confining the activities of the Imperial Bank in London mainly to its own old Indian customers.

The chief counts of indictment against the powerful foreign exchange banks as they exist now are that they compete with the Indian joint-stock banks not only in the matter of securing deposits but in financing borrowers in the slack season, that they remit funds from India whenever tight money exists in foreign countries, that they drain away resources from this country for services which can be performed equally efficiently by progressive domestic banks, that they drain away funds for investment in foreign industrial and gilt-edged securities, that they promote trade in raw materials and the industrialisation of the country is no definite policy, that they refuse to give a confirmed letter of credit even to first class Indian importing firms unless they deposit 10 to 15% of the value of goods of their own, that they refuse to adapt themselves to the requirements of a great agricultural country like India where produce advances are more necessary and should be made freely,[32] that they do not give us an adequate return for the 'open door' policy we maintain, that they do not give us reliable information concerning foreign markets and prices, that they form a compact homogeneous group and give no positive encouragement to the Indian bank clerks to rise to positions of official responsibility, that they tend to drain away funds from up-country centres to the ports in the busy season thereby leading to better financial facilities, to exporters rather than the cultivators and industrialists, that they give very poor references regarding

[32] This they can never hope to do so long as foreigners work the branches. Both in the directorate and superior staff Indians are rarely taken up. So the cultivation of sympathetic relations is not possible.

Indian customers so that D/A terms are not granted, that they have not set up economic standards of bank management and organisation before the Indian joint-stock banks who are financing internal trade requirements, that they do not buy remittance freely from the Indian joint-stock banks, that they stoop to unfair tactics against budding rivals,[33] that they are tending to amalgamate with the big London joint-stock banks and future Indian economic development might be served well or ill by these huge financial leviathans, that they tend to take call money from the Indian banks although they refuse to give the same to them, and that they will not fit in a nationally managed banking service which may be planned in the near future to develop our industry. In short they refuse to become instruments of national progress. In view of their past opposition to the Central Bank proposals, it is likely that they would refuse to co-operate with it.[35] Central Bank control might then degenerate into a mere fantastic dream. So long as Indian financial policy tends to be guided by the Secretary of State for India they can openly influence the same. They will never refrain from exploiting the Government of India whenever it tends to become embarrassed by currency, exchange and financial difficulties.

Quotation of Exchange Rates.

The exchange banks have unfortunately reproduced the same unscientific method of quoting exchange rates as in the case of the London Money Market. Take the Calcutta Money Market for example :—

33 Another count of indictment is that they do not give satisfactory references to overseas merchants regarding their Indian customers. The exchange banks compel the merchant-borrowers to insure with foreign Insurance companies in preference to strong and well-managed Indian ones.

34 The Eastern Exchange Banks have their own Association in London. Associations of these Exchange Banks exist in order to protect their common interests and to secure uniformity of practice amongst them. That admission to clearing organisation was sometimes refused to even strong Indian joint-stock banks was the mistaken opinion. No one member bank can exert greater influence than another in the matter of admission to the Clearing organisation.

35 See the Evidence of Mr. C. Nicoll before the Hilton-Young Commission, Ans. 14148, Volume V.

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Sterling rates were as follows —

Banks selling		
Telegraphic Transfer [36]	1·6	1/32 *d.*
On Demand	1·6	1/32 *d*
Banks buying		
3 months / sight bills	1·6	1.8 *d.*
4 months / sight bills	1·6	5/32 *d.*
6 months / sight bills	1·6	7/32 *d.*
Sight	1·6	3/32 *d.*
Telegraphic Transfer	1·6	3/32 *d.*

Other rates as follows:—

	Bank selling. On demand.	Banks buying 30 days' sight.
France (francs per Rs. 100)	564	——
America (Rupees per 100) ...	264 1/2	——
Hongkong (Rupees per 100) ...	99 1/2	96
Shanghai (Rupees per 100) ...	90	87 1/2
Singapore (Rupees per 100) ...	157	154 3/4
Japan (Rupees per Yen 100) ...	79	78 1/4
Java (Guilders per Rs. 100) ...	55 1/2	57 1/4
Germany (Marks per Rs. 100) ..	96	——
B.C. T.T. Rate [37] ...	1*s.* 6*d.*	
B.C. O.D. Rate ...	1*s.* 6*d.*	

[36] This is the sole basis of the exchange operations and the other quotations for demand and usance bills are based on the telegraphic transfer rates.

[37] B. C. rate is the bill for collection rate fixed daily by the Associated Exchange Banks Association. Their rate holds good when the acceptors of bills neglect to settle exchange with the banks. It is *not* the rate for retiring bills.

There are two methods employed in our daily quotation of exchange rates. The first method is to state rupees in terms of foreign currency as in the case of New York, Hongkong, Shanghai, Singapore and Japan. Here the number of rupees against the hundred units of foreign currency is stated. According to the other method of quotation foreign currency is quoted in terms of rupees. Here there are some anomalies. In some cases as in London and Melbourne rates the amount shown is equivalent to one rupee. In the case of France and Germany the exchange rates relate to the amount of foreign currency against hundred rupees.

As there is a difference in the methods of quotation such general expressions as " Buy high and sell low " and " Buy low, sell high " and " a falling exchange " acts as a stimulus to export trade " are to be cautiously interpreted, carefully noting the *method of quotation employed.*

Indeed it is high time to reduce these quotations to a *uniform* standard as America has done. Minty writes that " exchange rates were formerly quoted in America as they are still in England, some for so many dollars to the foreign unit and others for so many foreign units to the dollar. It has now become the universal practice to quote exchange rates so many cents to the foreign unit or if a finer quotation is required so many dollars and cents to the hundred foreign units." [38] In countries like Canada and France all exchange quotations are made in *home currency.* When will India develop such useful and simple quotations of foreign exchange rates ?

The meritorious services.

The above formidable list of their shortcomings and defects *does not mean that they are not of any use to this country.* As models of sound finance the Indian banking institutions can of course learn something from them. The Indian depositors would also have to be grateful [39] to them and every failure of an Indian bank has indirectly added to their prestige and deposit-attracting capacity. Their skill,

[38] *Vide* L. M. Minty, "American Banking Methods," p. 302.

[39] Though in the beginning they could not attract huge deposits in India, of late, their deposits are increasing considerably. A glance at the recent statistical tables relating to banks in India will prove this statement.

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freedom from dishonest manipulation of bank funds for directors' pet schemes and the maintenance of liquidity of their resources are indeed objects which ought to be the subject of proper emulation on the part of the Indian joint-stock banks. These have contributed much to raise the level of their steady profits which the exchange banks declare at present. But it should not be misunderstood that their progress in any way helps the economic uplift of India.[40]

War-time services.

During the war period in spite of a rising exchange and their limited financial resources " they heartily co-operated with the Government in the matter of financing the essential exports required for the war-purposes and the market rate of exchange was maintained near the rate at which Council Drafts were sold." [41] Encouraged by the Secretary of State's promise they bought export bills far in excess of purchases of exchange in the other direction.[42]

When the price of silver began to rise the sale of Council Drafts could not be made at the old rate without loss to the Government. Any under-valuing of the rupee might tend to make it disappear and so the exchange value of the rupee was made to follow the price of silver. From 27th August, 1917, the rates were changed as follows.[43]

40 Mr. Manu Subedar exaggerates this statement in his remark that " in either case the growth of foreign banking in India is a *symptom of malaise* and not a *symptom of robust health*"—"It bodes no good to Indian economic interests," p. 179, Minority Report.

41 *Vide* Sir H. B. Smith Committee's Report.

42 " The Secretary of State assured them against the risk of a rise in exchange by undertaking to sell to them within a year after the war exchange up to the amount of their overbuying at the rate at which their excess purchases had been made." *Ibid*

43.

Date of Introduction.	Minimum rate for T. T.	Date of Introduction.	Minimum rate for T. T.
3rd January, 1917	1·4¼	15th Sep., 1919	2*s*. 0*d*.
28th August, 1917	1·5	2nd Nov., 1919	2*s*. 2*d*.
12th April, 1918	1·6	12th Dec., 1919	2*s*. 4*d*.
13th May, 1919	1·8	2nd Feb., 1920	2*s*. 8½*d* (2*s*. gold)
12th August, 1919	1·10		

While it is the duty of the exchange banker to buy as n . Export bills as are offered and protect himself as best as he can, our exchange banks as soon as they find the free market in exchange breaking down would insist on the providing of full 'cover' for their purchases of export bills on the ground that it would otherwise force them to pile up a big over-bought situation. The whole of the funds would be accumulated in London with very little chance of getting them back to India. The exchange banks then refuse to operate except against "doubles." They sell remittances only against bills. Such measures generally cause inconvenience to export trade. This unfortunate situation can only be remedied if a Central Bank of Issue were to actively buy and sell foreign exchange as soon as the market rates threaten to get outside the specie points. Stabilisation of exchange within the specie points can be secured by the C. Bank entering into the exchange market on the supply or demand side as conditions require. Next, it is always possible to mitigate the evil consequences of exchange fluctuations by organising a forward market though of course the short-lived attempt on the part of the Government to maintain the official rate of exchange at 2*s*. (gold) led to further disorganisation of the exchange situation.[44]

"*Forward Exchange Operations.*"

Such rapid fluctuations in the exchange value of the rupee made the exchange banks rather cautious in their "forward operations" of exchange. As Prof. Keynes says "a forward contract is for the conclusion of a spot transaction in exchanges at a later date fixed on the basis of the spot rate prevailing at the original date. Pending the date of maturity of the forward contract no cash need pass (a security as proof of ability to complete the contract is generally taken by the exchange banks) and he is protected from the consequences of any fluctuations in the exchanges in the mean-time."[45] By this method of dealing the importer-merchants and the exporters try to eliminate trade risks as they are ignorant of the intricacies of

[44] For a detailed account of the Indian exchange situation in the year 1920 the readers should consult the author's article in the *Calcutta Review*, February, 1922.

[45] J. M. Keynes, "Tract on Monetary Reform."

exchange. The exchange banker while undertaking to eliminate these risks due to fluctuations in exchange protects himself by "setting off" or "hedging" one operation against the other. He "covers" himself by setting off a sale by a purchase or *vice versa.*

Facilities for forward exchange.

Even in a managed paper currency as sponsored by the English economist J. M. Keynes, sudden fluctuations of the exchange rates are to be prevented by the C. Bank having a buying and selling price of gold. This range of gold prices would stabilise exchange rates within limits similar to those set by the specie points in the gold standard system. As the object of the managed paper currency system is to secure a constant and stable internal level of prices this ideal would not be sacrificed if the world price-level were to fall. The exchange rate would be allowed to rise in proportion to the new discrepancy between internal and world prices. The C. Bank would then introduce a new buying and selling price of gold which would closely correspond with the new level of exchange rates. It is excessive short-time fluctuations of exchange rates that cause disturbance to trade and these are eliminated under the scheme of Mr. Keynes. He would permit relatively permanent movements of exchange rates.[46]

In India up till 1893 when the mints were closed for the coinage of silver, the Exchange Banks used to buy and sell forward exchange freely. Their charges for this service varied from week to week and depended entirely on the London discount rates and the merchants' own estimation of the risk. The Government of India have recently fixed the domestic Rupee at 1*s.* 6*d.* or a fixed weight of gold. This fixed ratio to the foreign unit is to be maintained so that the value of domestic currency conforms closely to the value of the gold or foreign unit. Like the recent operations of the Reichsbank which is permitted to redeem at discretion in gold bullion or gold exchange the Government of India can likewise convert the domestic currency into gold bullion or gold exchange. Under this effective gold exchange standard system where sufficient reserve is held in London, there is a

[46] J. M. Keynes, "Tract on Monetary Reform."

free market for the merchants in exchange and they would not naturally go in for these forward contracts. It has already been stated that it is the lack of stable standard of payments that renders necessary the provision of forward exchange.

Being an agricultural country India has seasonal exports and during this time the exchange banks' purchase of export bills would be greater and it would be difficult to " marry " the forward purchases with forward sales. The sterling balances would be increased and as soon as their export season is over this position would be reversed. The exchange banks sometimes transfer funds to the Indian money market to lend them at a favourable rate. When there is a superfluity of local resources, the Indian exchange banks make similar operations in which *a ready purchase* may be covered by a *forward sale*. Broadly speaking, the practice of covering exchange forward is always advisable for the merchant. Even in time of peace merchants should cover their dealings in the export trade three to six months forward and in the import trade perhaps a year or more. It is sound business to cover all exchange risks with the banks. Otherwise it would be introducing an undesirable amount of speculation.

General aids to their business.

The exchange banks are few in number and with their close-knit organisation they succeed in obtaining more than competitive profits. It is true that Indian export business is seasonal and the trade is always of a fluctuating character. Hence the rates of commission the exchange banks charge for their service ought to be higher than what other countries' banks make but they charge a much higher rate. It is also true that the Government's position as a debtor in terms of sterling and collection of revenue in rupees and its attempt to keep prices steady in the latter currency enable the exchange banks to take advantage of the situation.

Wide Margin.

It has already been stated that when exchange fluctuates the exchange banks sell low in order to protect themselves. Taking

the Paris rate of March, 1924, which was 740 Francs, it can be proved that they were selling low as it was then subject to fluctuations. By the *chain rule method* this statement can be verified.

How many Francs = Rs. 100 ?

$$\text{Re.} = 1s.\ 4\frac{11}{16}\,d. \text{ or } \frac{267}{16}\,d.$$

(Banks selling rate for demand bills)

240*d.* = £1.

£1 = 11,840 francs (Quotation of exchange on London at Paris.)

Hence the required number of francs—

$$\frac{100}{100} \times \frac{267}{240} \times \frac{11840}{16} = 823{\cdot}25 \text{ francs.}$$

Vested Interests.

The attempt of the exchange banks to perpetuate their new monopoly will never succeed.[47] Although they have once again succeeded in confining the exchange business of the Imperial Bank of India solely to its own customers, yet it is doubtful whether their monopolistic position will always prevail. Foreign exchange business is a paying one provided unnecessary competition between the exchange banks is eschewed altogether. As the resources of the Indian joint-stock banks increase the struggle for profits would become keen. There would be an effective challenge and real competition with the exchange banks. The newly arising national spirit prompts the people to retain these profits within the country. The desire to retain natural surplus

[47] See J. M. Keynes, "Tract on Monetary Reform," p. 190, *et seq.*

profits arising from the financing of our foreign trade[48] so that the slowly increasing number of our industries and industrialised agriculture may have the necessary sinews of war, is becoming more prominent than before. As this national sentiment grows in intensity the Imperial Bank itself might be asked to finance our foreign trade,[49] and the present restrictions hindering the undertaking of general exchange business might be removed or else a new Indian Exchange Bank may be started for conducting this business.[50]

Our commercial banks would not be undertaking any risky business if they were to compete with the exchange banks for this exchange business. Although the conversion of foreign money into domestic and *vice versa* is somewhat difficult, as an element of speculation always enters in exchange transactions between countries having different metallic currencies, and although various influences operate on the rate of exchange,[51] it is not difficult to undertake foreign exchange business.

[48] Indian economists point out that our foreign trade is wholly financed by the foreign banks and this annual tribute depends on the amount of trade that is financed by them. Our normal trade figures are estimated at Rs. 800 to 500 crores. Taking the lower figure as the basis of our computation and supposing that the average bank rate is 4% on an average usance of three months the exchange banks would obtain a return of 5 crores a year.

[49] It reminds the readers of the monopoly maintained by the Australian banks in the Commonwealth. No London bank can hope to secure a footing in the Commonwealth of Australia. The same is the attitude of the South African banks. No London bank can establish itself in Johannesburg. There is a ring of banks controlling the rates of exchange which are fixed for definite periods and advertised. Customers as well as banks outside this ring who have to buy exchange conduct their transactions through them. A market in forward exchange is impossible on account of this ring. There is a total lack of freedom and anonymity in the foreign exchange market as in other countries See Phillips, "Modern Foreign Exchange." Forward Exchange Banking has become much improved since that date.

The Indian situation is not so hopeless as this but still the Eastern Exchange Banks have a thorough control over the exchange market. Since these lines have been written the Reserve Bank of India has been asked to buy or supply sterling exchange of stated amounts to all customers requiring the same at established rates for the rupee.

[50] This was the self-same suggestion given out by the Central Banking Enquiry Committee. Why it is inferior to an Indian Overseas Bank will be related in a succeeding chapter.

[51] Clare says "A rate of exchange is the condensed effect of a variety of facts and forces which are too numerous and too complex to admit of direct appraisement and in the majority of cases the best explanation we can give of an exchange movement is to pick out one prominent cause and hazard a guess at the others." See A. B. C. of Foreign Exchange.

Suggestions to overcome these difficulties.

Apart from securing all the advantages arising out of financing our foreign trade with the help of domestic resources [52] there should be an equal division of labour in the matter of discounting and handling internal and foreign bills of exchange. While the discounting of internal bills of exchange is not accompanied by any serious risk provided these banks discounted first class trade bills arising out of the movement of crops, *i.e.*, foreign trade and internal trade are to be handled by different institutions ; the former by the exchange banks, the latter by the domestic banks. It presupposes an intimate knowledge of the trade relations between the two countries and this can be grasped only after several years' experience. The relative value of the two currencies of the trading countries should be fully known. Any likelihood of trading expansion in the near future should be clearly realised.

Dealings in Future.

Besides overcoming these initial difficulties the banks that undertake this business should avoid speculation in exchange on their own account. They should be careful in keeping their purchases and sales of exchange for various dates of delivery as nearly equal as possible. Occasionally they can make *an excess of sales or purchases* but broadly speaking an *overbought* or an *oversold* situation is not advisable.

Conditions of safety.

For a safe and efficient conduct of this business branches in foreign monetary centres are necessary and the incidence of cost of

[52] See my evidence before the C. B. Enquiry Committee. Both trade prosperity and trade adversity fluctuations can be adequately financed by the Indian exchange banks with the help of C. B. resources. The stopping of unnecessary tribute to the exchange bankers for financing our foreign trade, the possibility of creating rupee bills in import trade, the privacy of discount market, free possibility of securing safe and sound employment for the increasing short-term liquid resources of our banking system, the development and use of bank acceptances and the smooth functioning of the C. Bank of our country if a properly organised discount market arises out of the efforts of the Indian exchange banks—are some of the prominent advantages arising out of the financing of foreign trade with domestic financial resources. Both Japan and America have developed domestic machinery for undertaking this financing of their foreign trade with the help of their domestic resources. Why should not India follow in their footsteps ?

such branches is very high in the beginning. Agents can however be employed but they might mismanage.[53] The foreign exchange department must be in the hands of a trained specialist. Clerks possessing good knowledge of foreign languages are necessary. The domestic needs or policy of the bank should be borne in mind by the head of the exchange department of the bank and it is difficult to keep both the domestic and foreign operations of the bank each involving large outlay of capital, in close harmony with each other. The brokerage and establishment expenses must not be allowed to run high so as to absorb the margin of profit in exchange operations.

Provided our commercial banks do not underrate these difficulties there would be nothing unwise nor would it be inherently unsound if they were to attempt to undertake exchange business. It is by healthy and vigorous competition with such strong banks that the Indian-managed exchange banks can ever hope to learn their business and profit by it. It is unwise to restrict their entrance to this country. But as exchange-cum-commercial banking would be expensive, dangerous and liable to be defeated a separate Indian Overseas Bank ought to be started.

Suggested restrictions against the Exchange Banks.

In addition to developing the Indian exchange banking machinery it has been suggested that an attempt should be made concurrently to impose certain legal restrictions which will crib, cabin and confine the activities of the foreign exchange banks. The withholding of the right to attract Indian deposits, the precluding of the foreign exchange banks from the rediscounting privilege at the hands of the R. Bank, the closing of the 'open door policy' so that in future no foreign banks might gain access to the

53 The Alliance Bank of Simla which failed in 1923 was forced to open a branch in London on account of failure of Messrs. Boulton Bros. and Co., who locked up their money in their own operations in the London Money Market.

Indian money market, the restricting of the freedom to open branches in the interior, the confining of the activities of even the present-day exchange banks to the port centres alone and the compelling of even the existing exchange banks to secure a license for conducting banking transactions, which license itself should be actuated with the sole desire and ardent motive of earmarking the internal banking field at least to indigenous banking concerns, have been the restrictions suggested by various authorities. That other countries have enacted some of these restrictions against foreign banks is one main ground for their justification. That England, the U. S. A., France, Italy, Denmark, Japan, the British Dominions and Turkey enact such measures is easily known and a glance at the memorandum on commercial banks issued by the League of Nations will reveal these restrictions.

General Objections.

In view of the fact that most of these ill-founded suggestions do not bear close scrutiny and are apt to land the country into further depth of misery retaliatory legislation of a punitive character should not be passed on the spur of the moment. In view of the fact that the World Economic Conference [54] has passed resolutions to the effect that "No discriminatory legislation" against foreigners should be enacted our attempts should be in the direction of inducing them to have a real change of heart. In view of the powerful influence the exchange banks wield in the London financial circles it would be impossible to enact any punitive or procative taxation measures against them so long as they confine their activities to international commerce alone. The recently passed Government of India Act forbids the passing of such legislation even though it might be in conflict with the best interests of the nation in general.

Possibility of evasion.

Before pointing out the desirable terms of the license which the exchange banks ought to secure it has to be understood that all the

54 See the Report of the World Economic Conference published by the League of Nations, Volume II, p. 42. See also the Proceedings of the International Conference on the treatment of foreigners held in 1929.

other measures can be easily evaded by the foreign exchange banks who can register themselves with rupee capital as local banks. Such has been the case in Spain.[55] As the Indian banking field is wide enough to permit the successful working of a number of banking institutions they would not lose this opportunity to defeat the real intentions of any penal legislation that can be enacted. But as I have stated elsewhere, if these local banks are forced to maintain an up-to-date register of shareholders [56] there would be no possibility to escape this legislation. For the purpose of this act it can be enacted that all banking companies whose shareholders' list has more than two-thirds of its members from outside the country would be considered as foreign banking companies.

An examination of the proposed restriction.

The restriction of the right to attract deposits is fraught with real danger.[57] Many of the nationalists and swarajists of our country who wax eloquent on the necessity of cultivating the "swadeshi" spirit have deposit accounts with the soundly managed foreign exchange banks. Although there are other banks and branches in all places where the exchange banks are conducting their business still the *suggestion to rob Peter to pay Paul* will not succeed. The exchange banks would increase the cost of services for financing the foreign trade. Their deposits will not be transferred to the Indian-managed banks. Perhaps it would be too pessimistic if it is stated that there might be recrudescence of the hoarding habit or the Imperial Bank of India would secure a semi-monopolistic hold over Indian deposits. The attempt to repay the Indian depositors would compel the exchange banks to sell their securities and this would mean low and depressed prices for Government securities.

[55] See the Chairman's Speech—the Westminster Bank's Annual meeting, 1923, See Sykes, "The Present Position of English Joint Stock Banking," p. 28.

[56] The newly enacted Company Law of 1929 of the United Kingdom contains this provision. A penalty is also imposed if the index to the register of the shareholders is not kept up to date. See sections mentioned in Part IV of the New Companies Act of 1929.

[57] They point out exultingly that such a law exists in the state of New York.

The closing of the rediscounting privilege as is the case in western countries with those foreign banks which conduct business therein would not greatly affect them. They can virtually depend on their London resources, high capital holdings of their own and their deposits *in India and out of India.* They can, if they are so minded, literally snap their fingers at and refuse to co-operate with the Reserve Bank of this country. However, as they have signified their willingness to co-operate with the R. Bank this rediscounting privilege ought not to be withdrawn. It is but equity and common justice on the part of the exchange banks which have kept their cash reserve deposits in the R. Bank to expect the rediscounting privilege in return for the same. This compulsory depositing of cash reserve against their total Indian demand liabilities would strengthen their liquid position and their present-day tendency of keeping a dangerously low position of cash reserve in India against Indian liabilities would be curtailed.

The suggestion that the "open door policy" should be withdrawn and that we should follow the policy of modern Turkey which has been turning out even long-settled foreigners bag and baggage from out of the country is only an extremely undesirable instance of the policy of economic nationalism and economic autarchy. Apart from sentimental justification of this measure there is no other strong reason which can support this line of action. Fortunately for the country the maintenance of commercial safeguards in the new constitution forbids the enacting of such measures.

The freedom to open branches in the interior is indeed essential for an all-round banking service can never be performed economically by the exchange banks if they refuse to enter the internal banking field. The opportunity of appointing the Indian joint-stock banks or the indigenous banker as an agent to perform this service would only mean sharing or dividing the profits of the undertaking which can be easily annexed by themselves. The main intention of securing Indian raw materials for exportation out of the country would be defeated. The possibility of finding a market for the imported goods for their customers in the internal areas of this country would also be lost. Besides there is no watertight division between external trade financing and internal trade financing. A continuous stream of services would be necessary to complete their business in the financing

of our exports and imports. Their presence on the spot, *i.e.*, in the internal trading centres leads to great economy.

Some Terms of the Licence.

The exchange banks ought to realise that the right to conduct banking business is indeed a valuable privilege for the granting of which sufficient payment or *quid pro quo* can be exacted from them. Apart from ceding a portion of their gains and the publishing of monthly circulars of their activity on lines chalked out by the Reserve Bank there ought to be the compulsory training of a number of Indian apprentices in exchange banking business. A most desirable consequence resulting out of the above measure would be the possibility of confining the attention of the exchange banks to Indian business and fostering production in India. In times of stress and stringency they can rediscount these bills at the Central Bank of Issue in the United Kingdom. When aliens are allowed to trade or conduct business they are bound to train English subjects in the new process of production or lines of business. In actual practice the exchange banks of the Indian money market receive what amounts to a national treatment in every respect and the promotion of our national interests must be one of their primary objects. In the matter of amalgamating with other banks or opening branches in the interior the exchange banks ought to secure the sanction for the licensing authority. Our appeal to them to act as indispensable adjuncts to a nation-wide banking system would be vain if they display no real change of heart.

The Real Remedy.

Although the growing national sentiment of the country prompts us to take immediate action *still the real remedy is to proceed cautiously*. Though our policy should be based on the justifiable motive of destroying all vested interests the retention of the exchange banks *as useful complements* in our banking organisation is the only wise alternative that is left to us. In the beginning we will have to supplement their services. After the lapse of certain time we can hope to counteract their influence. Our local exchange banks must be helped by the C. Bank to realise this aspiration. As in Japan we should retain them in the banking system as *willing helpmates, useful brethren and*

subsidiary institutions. They must become a cog in the Indian banking wheel. Their present-day uncontrollable and unassimilable part in the banking system and their acting as the chief controllers of our economic progress must be remedied.

If the exchange banks tend to ignore these recommendations and show no signs of adaptability to changing circumstances the Indian people would have to implicitly follow the footsteps of the nationalists of China who are now taking vigorous steps to protect their economic interests.[58] Although we can institute no such line of action for a comprehensive bankers' guild nowhere exists, still no attempt should be made by the foreign banks to keep the Indian exchange banks that may be started in the future weak and helpless for the promotion of their own selfish ends.

An unpardonable exaggeration.

It is nothing but sheer exaggeration to remark that "no important country of the world other than India has allowed foreigners to capture its banking activities." The power of the foreign exchange banks is simply overstated. As in China we do not find the foreign banks issuing notes[59] and controlling our currency. The bulk if not the whole of the foreign trade lies in their hands but there is no trespass on our sovereignty by controlling the currency organisation by their own note-issues. It is the stability of these banks that has added largely to their size and influence and the failure of every Indian joint-stock bank has indirectly added to their prestige and deposit-attracting capacity. The distribution of these deposits is entirely a lop-sided business shifting towards larger and stronger institutions with the inevitable result that these have little business when compared with their resources.

[58] The Bank Clerk's Union in Shanghai has issued the famous twenty-seven demands to their employers—the foreign banks and the carrying out of these demands would mean that the foreign banks can operate only by the grace of the union. For an idea of these 27 demands, see Lt.-Col. P. T. Egerton, "China—the Facts," pp. 229-32.

[59] The Chartered Bank, the Hongkong and Shanghai Bank and the Mercantile Bank issue notes in denominations of 100,50,10,5 and 1 dollars. In the month of September, 1927 their total issue amounted to 62,589,240 against which a special reserve of 40,380,000 was kept. See W. F. Spalding's "Dictionary of World's Currencies," p. 94.

TABLE I (*showing the progress of the Exchange Banks*).
(1,000 omitted.)

Years.	No. of Banks	Paid-up capital £	Reserve £	Deposits in India Rs.	Deposits outside India £	Cash Balances out of India £	In India Rs.
1905	10	15,204	7,291	1,10,445	94,563	21,504	37,813
1910	11	21,734	12,610	2,47,917	134,166	17,810	43,851
1915	11	22,681	14,112	3,35,456	179,948	45,383	76,013
1920	15	54,198	36,019	7,48,071	513,671	84,197	2,51,753
1925 A	5	9,644	10,033	4,81,345	65,786	9,703	97,118
,, B	13	73,394	47,863	2,17,003	778,896	104,045	66,551
1930 A	6	9,769	11,023	4,56,038	63,809	13,243	58,504
,, B	12	96,575	89,200	2,25,106	1,132,251	195,680	12,585
1932 A	7	10,019	8,731	4,83,100	66,355	15,698	57,866
,, B	11	88,090	67,006	2,47,556	1,048,974	193,552	38,133
1934 A	7	10,019	8,981	4,56,696	70,032	15,823	43,555
,, B	10	72,401	50,217	2,57,321	922,220	200,945	33,272

A—Banks doing considerable portion of their business in India, *i.e.*, 25% of their deposits in India.

B—Banks nearly agencies of large banking corporations doing major portion of their business abroad, *i.e.*, having less than 25% of their deposits in India.

TABLE II (*showing the Balance of International Accounts*).

	Average of 10 years ending 1913-14.	Average of 10 years ending 1931-32.	1932-33.	1933-34.	1934-35.
Exports of Indian merchandise (private)	+19,467	+30.454	+13 338	+14,877	+15,273
Re-exports of foreign Merchandise (private).		+945	+322	343	+357
Imports of foreign merchandise (private) (*b*).	−19,294	−21,133	−13,642	−11,918	−13,639
Balance of Trade in Merchandise (private).	+7,174	+10,266	−12	+3,302	+1,931
Gold (private) (*a*).	−2,087	−2,068	+6,552	+5,705	+5,254
Silver (private) (*a*).	−767	−1,467	−73	−1	−37
Currency notes (private) (*a*).	...	−24	+14	+19	+37
Balance of transactions in treasure (private) (*a*).	−2,854	−3.559	+6,493	+5,723	+5,254
Total visible balance of trade.	+4,320	+5,207	+6,481	+9,025	+7,185
C. Bills and t. t. paid in India purchase of sterling from banks and firms in India and payments for sterling taken over in London from local bodies.	−3,847	−3,203	−4,818	−5,997	−4,982
Sterling transfer on London sold in India.	+122	+287	...	...	...
Transfer of Government securities.	−71	−16	−13	−11	+32
Interest drafts in India in respect of Government of India securities.	...	−37	−32	−36	−28
Balance of remittances of funds.	−3,796	−2,969	−4,863	−6,044	−4,978
Total visible balance of accounts.	+524	+3,238	+1,618	+2,981	+4,207

TABLE III (*relating to dividends and prices of their Bank shares in India*).

Exchange Banks.	Paid-up share. £	Quotation on 3rd June 1936. £	1927.	1934.	1935.	1936.
1. The Chartered Bank of India, Australia and China.	5	14⅞	20¼	14	14	—
2. The Eastern Bank	5	Rs. 87	8	9	6	—
3. The Hongkong-Shanghai Banking Corporation.	125	123½	64	48	44	—
4. The Lloyd's Bank	1	3$\frac{1}{16}$	16⅔	12	12	—
	12½A	31¼	16	12	12	—
5. Merchantile Bank of India.	12½B	31	16	12	12	—
	5C	14¼	16	12	12	—
6. National Bank of India.	12½	43⅞	20	18	18	—
7. P. & O. Banking Corporation.	10	10¼	5	5	5	—

See the "Capital," June 4, 1936, p. 900.

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CHAPTER V

An Indian Overseas Bank

Absence of orderly banking policy—Business of the immigrant banks—Other items of business—No real change of heart—Diverse programmes—A. B. C. D. E.—Organisation of the I. O. Bank—Helpful concessions—It's *modus operandi*—Advice of foreign banking experts—Attitude towards joint-stock banks—Excellence of the plan—Some of its advantages—The rupee bills—Objections of a recent writer answered—Conclusion.

Absence of orderly banking policy.

The lack of an orderly banking policy is nowhere more strikingly illustrated than in the direction of financing our foreign trade. Apart from the foreign control of Indian banking resources the natural advance of Indian joint-stock banks [1] in the direction of financing the foreign trade of our country and the conducting of internal banking has been checked by the presence of immigrant banks which number about 19 and manage to bring about a " foreign money trust " and an insidious system of " economic penetration " into the interior of the country.

The business of the immigrant banks.

As Manu Subedar says, " the foreign banks are helping their nationals with finance to handle both import and export trade from Indian money, that after this, they have still large sums left with them which they engage in internal banking and from which they are helping their nationals to penetrate in the trade,—as far in the interior

[1] Foreign banks take deposits from Indian banks but they never allow these Indian banks a single rupee without security although they transact a large volume of inter.-bank call-loan business.

[2] It is indeed an extraordinary oversight that the C. B. Enquiry Committee always manages to state the number of the exchange banks at about 18 and not 19 which correct

as possible and that they have in recent years increased their activities in internal banking [3] to an extent which makes the position not only difficult and hazardous for Indians engaged in trade but also perilous and unprofitable for Indian Joint-Stock Banks."

Other items of business.

The immigrant banks finance bullion trade, undertake remmittance and agency work, purchase sterling securities for Indian investors, issue letters of credit and handle the bulk of invisible imports into India.[4]

They make profit out of the movement of permanent capital in India, the withdrawal of capital and the transfer of income on such capital. The British Exchange Banks receive huge Indian deposits and lend a portion of the same in India. The available statements beyond the one of Nalini Ranjan Sarkar do not confirm the usual view held that " they tend to drain away resources from India." At any rate even the figures of N. R. Sarkar point out that the non-British Exchange or " immigrant " banks generally tend to bring capital from " Home " while the "British Exchange Banks do not bring money from abroad." In the absence of a continuously arranged statistical data extending over a series of years nothing definite can be stated.

Elsewhere I had occasion to point out their anti-Indian attitude and other [5] defects of policy common to both types of immigrant banks, British or non-British. It is a patent fact that they are not

[3] The witnesses representing the exchange banks admit this in their evidence before the different Currency Committees and Commissions. The Bank of Bombay emphasised this point in the year 1919 while pleading for the amalgamation proposal which led to the creation of the Imperial Bank of India.

[4] For a detailed description of the business of the Exchange Bank see the chapter entitled " Foreign Exchange Banks " in my " Present-day Banking in India."

[5] See my written evidence before the Central Banking Enquiry Committee. An exhaustive catalogue of these defects would have no value at this juncture. It is not only with the view of ventilating these grievances that they have been aired before the C. B. Enquiry Committee but the motive has been to secure a real change of heart. As no signs of this benevolent attitude can be counted upon except in a very limited sense it can be safely concluded that they desire to retain a ' perpetual stronghold " much to the detriment of Indian internal banking business.

" an element of strength " to the Indian banking system. The Minority Report of the C. B. Enquiry Committee raises the contentious issue that the exchange banks do not make proper contribution to the taxes of this country for the protection that they receive.

In spite of the frank appeal of Sir P. Thakurdas to the Exchange Banks Association to allay the fears of the Indian commercial community and issue a memorandum nothing solid has been done hitherto for placating the sentiments of the Indian mercantile, insurance and shipping circles.[6] How far " the policy of give and take " and a spirit of professional comradeship with Indian banking institutions have been inaugurated is not known to the general public. Although they secure cheap Indian deposit Money and rediscount their bills cheaply in the London money Market they have failed to cheapen their banking service to the Indian exporters and importers.[7] As dependence on alien institutions is a dangerous folly, as substantial services can be rendered by an Indian Exchange Bank in the direction of financing foreign trade with the help of domestic resources, as other foreign countries notably Japan, America and France have created foreign exchange banks to finance their growing export trade, as the limitations of foreign exchange banking activity in the legitimate interests of the Indian joint-stock banks would render us helpless if an Indian Exchange Bank were not to be in existence, as the smooth financing of the Reserve Bank would be aided by a thorough control over these immigrant banks which otherwise would form an unassimilable portion of the Indian banking system and as the concurrent development of the Indian Exchange Bank along with the Reserve Bank would facilitate the smooth functioning of both the Banks no time should be lost in developing an Indian Overseas Bank for financing our foreign trade. Besides there are some positive

[6] The lowering of the import bill financing rate to five per cent., the publishing of the rules of business between themselves and the exchange brokers and the issuing of instructions to the Exchange brokers and bankers to deal more favourably with the Indian Insurance Companies are the resultant advantages.

[7] The export bills are bought at one per cent. above the foreign centre's bank rate—minimum being two per cent. The import bills are charged five per cent. and the cost of remitting funds to Great Britain is always added to it. The terms of the famous Eastern clause need not be recounted here in full.

advantages arising out of financing our foreign trade with the help of domestic resources.[7a]

Diverse programmes.

Though there is a consensus of opinion that at least one *major* Indian-owned and Indian-managed Exchange Bank should exist there has been some diversity of opinion concerning the manner of ushering in this Indian Overseas Bank into existence. As many as five major schemes have been placed before the Indian public.

Scheme A.

The Majority Report of the Central Banking Enquiry Committee mentions the possibility of developing the Imperial Bank of India into an Exchange Bank (*vide* paras. 483 to 485). That it has enough resources, that it has a vast number of internal branches, that it has the needed personnel capable enough of conducting the paying exchange banking business, that it has already been conducting foreign exchange banking business, that it has in London its own branch and correspondents abroad and that it would be freed from vexatious restrictions as soon as it loses its semi-central banking nature as a result of the starting of the Reserve Bank, are the chief arguments advanced by the C. B. Enquiry Committee Report itself.

Writing several years before the C. B. Enquiry commenced taking oral evidence I have had occasion to point out that the Imperial Bank of India ought to develop as the premier commercial bank of the

[7a] An unnecessary tribute is being paid to the London bankers who accept our bills and discount them in the L. M. Market. Payment in sterling would be avoided and exchange risk need not be thought of. The privacy of the discount market and the keeping of trade information would be achieved. The newly arising national pride resents the financing of our trade by means of sterling bills. Free opportunity for a safe and sound employment of short-term liquid resources would be found in the discount market. The unwholesome over-investment of funds by the present-day Indian joint stock banks in gilt-edged securities can be checked. Nextly the C. R. Bank would be powerless and ineffective to control credit if the discount market does not exist. Other countries have organised agencies to finance foreign trade with the help of domestic funds. Japan and U.S.A. have organised similar attempts. See my evidence before the C. B. Enquiry Committee.

country and act as the spearhead of the Indian Joint-Stock Banking system.[8] The Hilton-Young Commission and the Minority Report of the C. B. Committee hold a like opinion.[9] As the C. B. Enquiry Committee itself recommends the starting of a state-controlled Indian Exchange Bank (para. 506) with privileges from the State and the Reserve Bank it apparently is not very sincerely and seriously upholding its own contention that the Imperial Bank of India should develop into an Exchange Bank.

It is almost a year since the Imperial Bank Act has been amended. In place of the Government business commercial business has expanded. Public Deposits and Ways and Means Advances have disappeared. Ordinary loans and cash credits have expanded. New Executor and Trustee Departments have been opened at the three head offices of the I. Bank of India. " Bills discounted " item does not appear as a *major* item in the assets of the Reserve Bank of India as yet.

Scheme B.

Coming to the suggestion of the Indianisation of the immigrant Exchange Banks which the Majority Report of the C. B. Enquiry Committee recommends it can be easily pointed out that an " Ethiopian cannot change his skin nor the Leopard its spots." The anti-Indian attitude might not be forsaken altogether. Apart from the inherent difficulties of Indianising their capital resources and directorate (*vide* para. 470, Majority Report) there is no reason why their established monopoly yielding high profits should be shared with the new Indian shareholders who can after all secure additional money alone.

Though this recommendation was made several years ago no immigrant bank has cared to Indianise its capital. Working with cheaply secured money from abroad they can afford to snap their

[8] The possibility of the exchange banks competing for state deposits would arise as soon as the Imperial Bank of India is allowed to undertake foreign exchange banking while acting as the agent of the Government funds. See the Letter, dated 8th Dec., 1904, from the National Bank of India to the Secretary of State for India.

See my paper, " The Future of the Imperial Bank of India " published in the "Calcutta Review."

fingers at the Reserve Bank or the Indian deposits if they refuse to deposit their money in their hands. Securing amalgamation with stronger banks of their own country they would prefer giving an honourable fight to the new Indian Exchange Bank rather than meekly yield and tamely submit to any attempt which might be made to endanger their vested interests and long-established monopoly.

Scheme C.

The idea of a "joint bank" for conducting foreign exchange business has been mentioned in paras. 490-492, Majority Report. It presupposes the existence of honourable and friendly co-operation on a footing of equality. If indeed such a spirit of mutual trust and goodwill had ever existed the Indianisation of their Indian branches would have proceeded apace. More Indians would have been trained in the higher field of exchange banking business. As these have not been secured up till this moment it is sheer idiosyncracy and criminal folly to sit with folded hands without making any efforts to secure an Indian enterprise in the lucrative field of foreign exchange banking.

Scheme D.

A state-owned and state-controlled Indian Exchange Bank acting in concert with the Reserve Bank presupposes the existence of enough share capital on the part of the state. Remembering that more insistent demands exist on the part of the public for founding other types of banks (*vide* Majority Report, para. 507) in directions which have been neglected hitherto, the suggestion that the available funds should go forth to form the share-capital for the state-owned and state-controlled Indian Exchange Bank which ought also to secure a monopoly of Government remittances has to be positively discouraged. The fact that the Reserve Bank itself is owned by private shareholders would negative the above proposal. Secondly, the monopoly of Government remittances smacks too much of autocracy in these days of enlightened democratic form of private enterprise. The foreign exchange banks would easily raise the cry that "it would be against all canons of equity." A partial state ownership even means participation of the state in the management of the exchange bank.

If the final object were to be the training of capable Indian personnel who will understand the intricacies of foreign exchange business the starting of a State Exchange Bank for securing this cherished motive would be wholly expensive. For other reasons adumbrated by the Foreign Banking experts and those mentioned by the Minority Report (para. 242) the starting of a State Exchange Bank cannot be viewed with any amount of satisfaction. Finally, there would be no responsible agency who is to bear the loss in case of failure of the State Exchange Bank. Private Indian enterprise would find it difficult to later on enter this field. If the State Exchange Bank would open branches in the interior it would hit the Indian joint-stock banks effectively in the direction of deposit business. Verily, it would prove as suicidal as the attempt of the proverbial Chinaman who burnt his house to learn the art of roasting his pig. Again the Constituent Act of 1935 prohibits the granting of bounties or subsidies to the Indian exchange banks without the same being paid to British Banks conducting business in India prior to the passing of the Act in 1935.

Scheme E.

Again, there has been the suggestion that the Reserve Bank should have a separate Foreign Exchange Department capable enough of undertaking foreign exchange business on a very wide and competitive scale with the existing foreign exchange banks. The advantage claimed for this suggestion is that mere unnecessary duplication of machinery would thereby be avoided. Competition at the hands of the Reserve Bank would be as equally effective as that forthcoming at the hands of a separate bank of the State, *viz.*, the State Exchange Bank. But it is curious that the author of this suggestion forgets that almost all the objections levelled against the State Exchange Bank can *ipso facto* be levelled at the handling of this business by the foreign exchange department of the Reserve Bank. Too many irons in the fire would spoil the entire situation. A big bank with multiplicity of departments and working with different aims would be less efficacious than one banking organisation concentrating its sole efforts on the conducting of the foreign exchange business which is admittedly of a highly competitive nature.

The scheme of an Indian Overseas Bank.

Rejecting the above schemes for reasons mentioned already the organisati n of an Indian Overseas Bank has been suggested. An Indian Overseas Bank whose capital is subscribed by the Indian Joint-Stock Banks, the indigenous bankers, the Indian manufacturers, members of the financial community like financial brokers, commission agents and shroffs and the general public has to be started with a substantial share capital of five crores somewhat on the model lines on which the Edge Act Banking Corporations have been started in America. Under the famous Edge Act the banking associations which were formed were meant exclusively to conduct international banking business, deal with foreign exchange and provide facilities for foreign commerce. The excellence of the plan consisted in making the manufacturers and banks associated with each other as share-holders of the bank. That the manufacturers will contribute business to the bank and that the Edge Bank will act as a distributing centre for acceptances, guaranteed paper and other obligations issued by the banks have been the bases on which the plan was organised. That manufacturers tend to obtain capital for their business from the investors through the bank and at the same time furnish business to the bank and participate in its profits was another expectation. A line of discount on foreign paper bearing some proportion to the capital invested will be granted to manufacturers who are stock-holders. Manufacturers and commission agents interested in foreign trade tend to provide through the stock-ownership a margin in the shape of capital which will furnish additional security for the obligation to be secured to the public. The I.O. Bank can issue its obligations say ten or twenty times in all to the amount of its capital and reserve. The Edge Act banking organisations educated the investors of the U.S.A. to the importance of financing its foreign trade. Just as the acceptance banks popularised the foreign trade acceptances so also the Edge Banks meant for promoting foreign investment habit created a broad market for the securities issued by them. It was in this way that the U.S.A. secured a permanent foundation for financing the foreign trade of the country with the help of domestic financial resources. Quite a similar policy should be the basis of the

working of the Indian Overseas Bank. This would simplify the problem of securing its customers.

Helpful concessions.

Aided by the special concession from the state of having its dividend guaranteed by the state during the first ten years of its existence [10] the possibility of securing enough capital resources can be assured. This bounty cannot be given according to the terms of the Government of India Act, 1935. But the Reserve Bank of our country should stand ready to grant interest-free loans ranging from 10 to 20 crores during the first ten years of its existence to this Indian Overseas Bank. Though it is a shareholders' bank it can be forced by the state to agree to this line of action in return for the note-issue and other valuable privileges offered by it.

The Modus Operandi of its business.

It can undertake the financing of foreign trade and conduct foreign exchange banking business. The Indian Overseas Bank has to actively finance the foreign trade by maintaining favourable rates in the initial stages in spite of the adverse cry being raised that objectionable state-subsidised competition is ensuing out of its action. Realising full well that unaided private enterprise would not meet with success against the solid phalanx of the foreign exchange banks the mere sentimental objections to state-help would have to be overcome.

Though aided by the deposits of its clients the Indian Overseas Bank has to secure a line of interest-free advances [11] and utilise them *as* and *when* required for financing the foreign trade of our country. Having a branch in London it can secure a part of this loan in shape

10 This after all is meant to secure high capital resources to the I. O. Bank. It would mean only some supervision on the part of the state to see that the state guarantee is not abused and does not become a dangerous liability. So long as profits are reaped the state loses nothing by this guarantee.

11 For an interesting parallel the conditions prevailing in France can be cited. The Bank of France subsidises many state activities in a substantial manner out of its annually accruing profits.

of sterling resources from the hands of the Reserve Bank's branch in London for the starting of which due provision has been made by the State in the R. B. Act of 1934. Having its parent offices in Bombay and Calcutta it can secure a part of this loan in shape of rupee balances from the hands of the Reserve Banks' Offices in these centres.

So long as the London Money Market refuses to rediscount the rupee export bills secured by the I. O. Bank it would be in difficult waters. But advantage can be taken of the above provision. Unless and until it has established itself the Government remittance programme will be conducted by the Reserve Bank. There would indeed be no monopoly of it, at any time, so long as the present foreign exchange banks remain in the field and compete for the same by means of open tender.

Acting as the agent of the Reserve Bank which controls the exchang. policy of the country it can hope to secure assistance even from the Bank of England so long as the Reserve Bank would be co-operating with the Bank of England. While the different branches of the I. O. Bank and the foreign correspondents and the London branch of the Reserve Bank would be helping each other in London and other foreign centres just as their parent offices would be helping each other in India their individual problems can be solved in a masterly way. Apart from the loans arranged the I. O. Bank has to be aided by preferential treatment in the purchase and sale of sterling resources by the Reserve Bank.

Securely based on the custom and good-will of the Indian joint-stock banks and the Indian trading public and adequately helped by the Reserve Bank in the matter of interest-free or cheap loans either in London or India the I. O. Bank can easily overcome almost all the early difficulties it would have to face in the beginning of its career.[12] If the national banking policy as formulated by the Legislature of the country were to change and negative the present-day policy of "open door" in the banking field the problem becomes

[12] Low level of commodity prices, lack of cheap but adequately trained staff, unstable exchange conditions and the lack of an international currency standard such as the gold standard are only mere temporary difficulties which can indeed be overcome by the display of tact, resolute will and persistence.

simplified in every way,[13] the fight becomes restricted to those 19 foreign exchange banks which have already secured solid foundations, great reserves, and enormous political influence. Suspicion and friction would soon ensue and the Indian Overseas Bank might not secure their co-operation in the London Money Market or depend on the possibility of securing sterling fixed deposits in London to help it. An adequately capitalised I. O. Bank can however depend on its sterling borrowing powers during periods of exceptional emergencies.

Some desirable changes needed in financing foreign trade.

Acting as the Indian Exporter's bank it can straightaway make an ordinary loan to the exporter or discount his bill drawn on the foreign importer. Sending it to the foreign area its branch or correspondent can collect the bill on maturity. It can advance a portion of the collection amount of the bill. While the above methods do not give scope to the creation of rupee bills the adoption of the method of refinancing acceptance should be encouraged. According to this method the Indian exporter has to send his bill to the I. O. Bank for collection. He has to draw a clean bill on the I. O. Bank which would be designated refinancing acceptance. This banker's bill drawn in rupee currency can be easily sold in the discount market by the exporter so as to secure ready funds. The I. O. Bank collects the original bill and makes ready resources to meet the second bill accepted by it. That is the present method of financing our exports by the confirmed letter of credit issued by the London importers' bank has to be changed. Coming to the import trade the I. O. Bank has to issue a confirmed letter of credit instructing the exporter to draw a bill calculated in rupee currency. Another method might be the issuing of the authority to purchase but as this method is

[13] If the invasion of the Indian Banking field by foreign banking institutions were to continue this line of action would become imperative. In America a foreign bank can open a branch of its own. Both in Australia and New Zealand the banking monopoly is carefully safeguarded through legislation. Even in India legislation against newcomers can be framed on the model of the above examples. The Constituent Act would have to be altered to secure this privilege.

decidedly inferior to the previous one attention should be rivetted on the letter of credit. The Indian Overseas Bank may give guarantee to the foreign exporters directly or through a correspondent. It covers the value of the bill but it does not assure the fact that the documents attendant on the bill are in proper order. But in both the cases the possibility of drawing rupee bills is assured.

While competing for bills in both directions the I. O. Bank would have to offer slightly favourable rates and having thus secured a clientele retain a permanent hold on them. This is the lesson that we learn from British Overseas Banking policy. The securing of the British customers in every possible way and offering no real competition with the native institutions which do not solicit foreign accounts in foreign currency have been the cardinal policies of the British overseas banking policy. The avowed aim in all cases was to increase the dealings of foreigners with Great Britain. "The organisation of intelligence and foreign exchange services was its main duty and it established many contacts with foreign institutions with the minimum of risk," says Dr. L. R. Robinson. It need not be emphasised that the Indian Overseas Bank should pursue a similar policy.[14] The recollaring of the internal banking business which has slipped into the hands of the Foreign Exchange Banks is another field in which a tough fight might ensue between the Indian joint-stock banks aided by this Indian enterprise and the existing foreign exchange banks. Unaided by the state in any other way except the guaranteeing of interest it would indeed take a long time to build up its business. During this period the help from the Reserve Bank in the direction of acting as its agent and the policy of interest-free loans either in London or India would have to be ungrudgingly given.

The Advice of the Foreign Banking Experts.

Even the foreign banking experts advise the creation of an Indian Exchange Bank with private initiative, capital and enterprise. As no spoon-feeding at the hands of the state is recommended in the

[14] See Dr. L. R. Robinson, "Foreign Credit Facilities in the United Kingdom."

above plan the I. O. Bank can be started as early as possible. The Indian importers can insist on their foreign customer-exporters drawing the rupee bills and presenting them through the I. O. Bank. Customer-shareholder-manufacturers are sure of supporting the I. O. Bank. Rupee export bills can be had from the very outset under the well-known principle of "refinancing acceptance." [15] Only the cheapening of the stamp duty, the development of acceptance credit in lieu of cash credit and the preparing of a common standardised bill form would accelerate this desirable tendency. If an increasing number of Indians participate in foreign trade business the clientele of the I. O. Bank would expand. Securing deposits from its customers alone it can eschew competition with the existing Indian joint-stock banks. Relying on the joint-stock banks for its internal bill-collecting business it can prevent any competition between itself and the Indian joint-stock banks. The main principle on which the I. O. Bank should regulate its Indian business is the one of conducting incidental business to the main one of financing our foreign trade. The moment that the Indian Overseas Bank is started and the Reserve Bank begins to help it in the manner outlined above the foreign exchange banks would be forced to give up their monopolistic attitude and adjust themselves to the new situation created by the genesis of the I. O. Bank. Their present-day policy of maintaining an *Imperium in Imperio* would be checked. So long as they are willing helpmates and useful brethren and act as subsidiary institutions in the banking system of the country they can be retained as a useful cog in the banking wheel.

The excellences of this scheme.

The excellences of this plan which is totally different from the existing schemes should be grasped. There is no monopoly of Government remittances handed over to this I. O. Bank. Secondly, the time and manner of making remittances are still the proper field and business of the Reserve Bank. Thirdly, there would be no dual authorities in the matter of the exchange policy of this country.

[15] See my written evidence before the C. B. Enquiry Committee.

The main task of maintaining the external value of our currency, by whatever method it might be secured lies in the hands of the Reserve Bank. It will help the national ambition and desires being realised in the least harmful manner possible. One such aspiration is to complete the credit cycle within India itself by providing the "missing link" in the economic chain, *viz.*, the I. O. Bank which connects the producer with the consumer.[16] The training and employment of Indians in foreign exchange banking field would be secured. That Indian jobbers, exchange brokers, insurance and shipping companies would be treated on a footing of equality with non-Indian ones can, of course, be secured by a paper convention with the present-day foreign exchange banking association but these wishes will never be translated wholeheartedly into action without a real change of heart. That the I. O. Bank can facilitate the realisation of this advantage without fail needs no particular emphasis.

The Indian Overseas Bank would help us to secure a legitimate share to the Indian people in the matter of financing our foreign trade. The securing of extra-liberal facilities by Indian firms and customers would be another advantage if the I. O. Bank begins to take an active part in financing the export and import trade of our country. The state of prevailing prices in the foreign markets can be communicated to the Indian customers thus tending to expand the export trade of our country.[16a] So long as Indian Marketing Boards do not do this it would be a desirable advantage. Against this suggestion of financing the foreign trade of our country by the I. O. Bank it would be impossible to level this particular line of criticism which the majority report of the C. B. Enquiry Committee

16 See the Punjab Banking Enquiry Committee Report, para. 106.

16a It might be contended that as the French attempts proved a failure similarly no outstanding result might be achieved if the I. O. Bank attempts to develop the export trade of our country. But this criticism fails to understand the difficulties which the French Bank had to contend. The French National Bank of Foreign Commerce was started in 1919 as a State-subsidised institution. An annual subsidy was to be paid out of the royalty conceded by the Bank of France to the Treasury. Loans without interest up to 35 mil. francs were to be granted by the State. The State was to have a share in the profit to a certain extent. But France could not achieve any success in expanding her Overseas trade. Her extreme protectionist policy and the excessive cautiousness of the national character are factors delimiting the expansion of her foreign trade.

developed namely, " that it would serve no purpose to divert the attention of the Indian Jt. St. Banks and the indigenous bankers to the field of foreign trade finance which is already well-organised. Their efforts should on the other hand be directed to the development and organisation of internal trade finance. Thereby great and lasting benefit would accrue to the country."

The Indian Overseas Bank can easily finance that part of the foreign trade, which consists in bringing raw material for export from the interior to ports and sending finished imported goods and raw material to Indian centres—though indeed such watertight division would be impossible in actual practice. Either the Indian Joint Stock Banks may do it or their counterpart the I. O. Bank may attempt it in such places where their branches do not exist. The undesirable competition of foreign banks in this field should and can be eschewed this way.

The Rupee Bills.

The foreign exchange banks have not cared to change the method of the financing of foreign trade. India is the *only* major country which has its import and export bills expressed in sterling or other country's currency. Rupee bills have not been developed in increasing quantities even in the matter of the import trade of the country. Apart from breaking up the monopoly of foreign exchange banks it is desirable that rupee bills should be freely drawn, accepted and discounted both in the export trade as well as the import trade of our country.

As a recent writer [16b] has stated certain objections against the practical realisation of this national aspiration a close scrutiny should be made of the real nature of the objections levelled against this measure. While the representatives of the Foreign Exchange Banks themselves do not place any objections in this direction but leave it to an agreement between the exporter and the importer (para 430, Majority Report) the foreign banking experts have levelled only two fundamental objections. This writer has increased the

[16b] See N. S. Iyer, " Foreign Exchange in India."

said number to a formidable list of ten. Before taking up his objections *in seriatim* the general objections mentioned by the foreign banking experts have to be understood. Unless these are effectively silenced the possibility of creating more rupee bills cannot indeed be entertained.

Firstly, it is objected to on the ground that the drawing of a bill in any currency arises out of an agreement between the exporter and the importer. Knowing full well the present-day tendency that manufacturers all over the world are drawing their bills in the currency of the importer there is no reason why the Indian importer should not insist on this practice. This means that Indian export bills should be drawn in foreign currency but the adoption of the practice of refinancing acceptance by the I. O. Bank would lead to the development of rupee bills. It must also be realised that a part of the Indian Export trade with China is conducted by rupee export bills. An exchange *per endorsement* clause would obviate the difficulty in drawing the rupee export bill in place of sterling bill in connection with our exports to colonies, the United Kingdom and America.

The second objection is that the price of an import bill drawn in sterling would be more cheap than that of a rupee import bill. As Indian money rates are higher a rupee import bill will not be drawn. Until Indian money rates are as low as that of London the rupee import bill cannot supplant the sterling import bill. The hollowness of this contention can be pointed out by the fact that " there are other countries whose interest rates are far higher than that of India but still their import trade bills are drawn in terms of national currency." Indian import bills are now charged a flat rate of 5% whatever might be the London rate of interest so that the contention that sterling import bills secure cheap London finance is a fabulous myth indeed. The cost of sending money back to London is added so that the importers really pay five per cent. *plus* X%.

The other arguments against the rupee bills would have to be examined *in seriatim*. The above author says that " rupees are not international currency—so rupee bills will not become popular in foreign trade." The *yen*, the *dollar* and the *mark* bills have indeed been drawn and popularised without their being used as international currency. The real objective of the importer is to secure new credit

facilities which would be created by the drawing of rupee bills. Indian joint stock banks can hold these rupee bills and thus secure connections in foreign trade an advantage which is now denied to them. Being drawn for small amounts they can be easily discounted and held by them.

Secondly, it is argued that " there is no organised discount market in India to hold these bills." It can be stated that the writer places the cart before the horse. The creation of the rupee import bills would develop the discount market and *vice versa*. A few rupee bills are being drawn already but this tendency has to be accelerated.

Thirdly, it is remarked that "the present-day exchange banks sit tight over the sterling import bills and do not discount them in the market." As a matter of fact the import bills can be retired before their due date of maturity by means of paying "rebate." It is just to counteract this tendency that the rupee import bill has to be drawn.

Fourthly, attention is drawn to the fact that " there are no Indian banks to popularise the rupee bills as the American, the Japanese and the British Banks are doing in the direction of the dollar, the yen and the sterling bills." This does not mean that the substantial gain accruing to the importer by a rupee import bill should be foregone. On the other hand it points out the imperative necessity to develop Indian exchange banks which can be easily popularising the rupee bills and begin to finance the foreign trade with the help of domestic financial resources.

Fifthly, it is stated that "the creation of rupee bills in both export and import trade would tend to shift the centre of interest from India to London and other places." That London is the world's clearing house and foreign exchange market is easily admitted by every banking student. That sterling export bills tend to be crossed against the sterling import bills in the London Clearing House would be the idea gained by the illustration presented by the author. This is just like seeing the wood as a whole and not paying individual attention to the mighty trees in the wood. Indian export bills are paid in rupee currency before they are despatched to London or foreign centres for collection in sterling and foreign currencies.

Indian import bills are first paid in sterling and foreign currencies before their rupee equivalent is finally paid by the Indian importer in Indian centres. The Clearing House analogy is indeed helpful in understanding that the balance of trade is normally in favour of India and ultimate payment should reach India for this amount.

Again it is stated that " import bills are chiefly D/P bills." They will not be available for discount in the Indian discount market even if they are rupee bills. Hence the building up of a discount market through rupee import bill machinery is an impossible task. Bills are either D/A or D/P according to the credit of the customers. If Indian import houses have a branch abroad they can secure this kind of D/A credit easily. The securing of this second signature would enable the drawing of a D/A import bill.

Nextly the writer observes that " the cost of accommodation would become higher in case of the rupee import bill." The real nature of the so-called cheapness of the sterling import bill machinery has already been examined.

Eighthly, it is stated " that rupee bills would facilitate more unnecessary import trade and one should oppose their introduction." [17] That imports pay for exports and *vice versa* is the most fundamental and elementary axiom in the field of economics. Apart from increasing Indian export trade which might be an incidental gain it can be pointed out that it satisfies the sentimental craving and national ambitions. This is indeed one aspect of the gain arising out of the rupee import bill.

Ninthly, the writer remarks that " Rupee import bills would militate against the interests of the Indian importers themselves." This is another " important objection." If rupee prices are insisted upon the American (dollar), the Japanese (yen) and the English (sterling) exporters would quote a higher price to cover up the possible fluctuations in the exchange value of the rupee. If the rupee were to be a gold rupee the possibility of exchange fluctuations adding to the rupee price of the importers would not arise. The burden of exchange need not be thought of in the presence of a forward exchange market

[17] This statement apparently is an exaggeration of the truth which says that the Exchange Bank should understand the drift of international monetary conditions and its London branch might form an important part of its equipment.

and a common currency standard between India and other trading countries. Under such conditions there would be no necessity to charge a higher price.

Finally, he clinches the issue by remarking that "after all Rupee bills are needed more in the direction of export trade as they tend to stimulate the export trade of the country." Although it is admitted that the Indian exporter has to compete with other countries the creation of rupee export bills which can be discounted by the I. O. Bank would ease his position yet the above writer opines that the Reserve Bank should at least have Rs. 100 crores to finance our export trade. This would mean the withdrawing of funds from the money market thereby tightening the flow of funds into the internal trade area. That a tight internal market would be experienced if the Reserve Bank were to shoulder the financing of both the export and the import trade and the internal trade of the country can be easily conceded.

But there is a grave overstatement of his case by the author in the above line of argument. The internal and foreign trade financing has to be done in either case by separate banks meant exclusively for the said tasks. The Reserve Bank ought only to lubricate the existing financing machinery by creating rediscounting facilities. That interest-free or cheaper money should be lent in the initial days to enable the I. O. Bank to successfully finance the foreign trade of the country cannot be disputed. The gathering of greater resources so as to avoid the tightening of the internal money market rates ought to be the main endeavour of the Reserve Bank. Endowed with the expanding note-issue privilege this problem is never a difficult one. A perpetual lending of cheap funds for financing the export trade causing detriment to internal trade financing is never the ideal expressed by any advocate of even the state-owned Indian Exchange Bank scheme. Even in the above scheme of the Indian Overseas Bank there has been an endeavour to steer clear of the Scylla of state-ownership and management and the Charybdis of monopoly of Government remittances.

It is indeed curious to find that the self-same writer makes the above suggestion almost forgetting the contradictory nature of his remarks. At one place he deprecates cheap loans to help export financing as it would tighten internal money rates. At another place he suggests the adoption of a loan policy to the Indian Exchange Bank somewhat

on the model of the Yokohama Specie Bank's loans from the Imperial Bank of Japan.

The drawing of the rupee import bills would free the importer from the clutches of the foreign exchange banks. The rupee import bill will facilitate the internal bill and rediscount market The Indian joint stock banks can secure desirable connections in foreign trade by holding these rupee import bills. Bills drawn in foreign currency would have to be paid at the B. C. rate. The Indian trader has to secure foreign currency from a member of the Exchange Banks Association unless indeed he has made previous arrangement and bought exchange already.

So long as the Sterling import bills do not secure the cheap open market rates of the London discount market for they are merely *purchased* by the Foreign Exchange Banks and not *accepted* and *discounted* in the London discount market the agitation for drawing the rupee import bills can never be effectively silenced. On the other hand the drawing of rupee import bills can be facilitated by the London branch of the Indian import house asking the I. O. Bank to confirm a credit to the London exporter and ask him to draw a rupee import bill which it would accept. The development of the rupee bill and acceptance credit has to be consummated. It should get it rediscounted in the L. M. market when its discount rates compare favourably with the Indian money market rates. This step should be resorted to if London exporters refuse to draw rupee import bills for the value of their exports.

In the matter of export trade the present cash credit facilities to the exporter have to be given up and rupee acceptance credit created in its place. The Indian exporter has to draw on the I. O. Bank drafts up to the limit of acceptance and get ready money by discounting these drafts. Securing the goods and sending them abroad he can have a draft drawn on London or foreign importer and sell these rupee export bills to other banks thus realising ready money for the goods despatched by him. He can repay the advances he has secured by means of acceptance credit at the hands of the I. O. Bank.

Conclusion.

The Reserve Bank has been started and as this new national institution the Indian Overseas Bank is needed for securing some of the

above advantages no time should be lost in making provision for creating such a body in consultation with the Reserve Bank.[18a] The prospect of trade revival is already looming in the horizon. The economic welfare of the country requires that the I. O. Bank which can secure the financing of imports and exports through its single agency should be started as early as possible by the combined action of the Indian joint stock banks, shroffs, the Indian export and import firms, and their agents and other business organisations. As it is small profits alone [19] which can be annexed in the initial days these rich parties should consent to undergo extra expenditure even to reach this desired goal.

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[18a] Since these lines have been written the C. B. of India is organising its London Bank mainly with the view of conducting exchange banking business. A separate bank with sterling capital of 100,000 is organised.

[19] The costly London branch, the huge capital resources most of which should be of a floating character, the costly trained staff which has to be employed, the highly competitive nature of the business and the rate-cutting which might be indulged in during the early years of its existence militate against the possibility of securing profits in the early years of its existence.

CHAPTER VI

THE IMPERIAL BANK OF INDIA

Introductory—Amalgamation of the three Presidency Banks—Constitution—Business outside India—Business in India—A balance-sheet of the Bank—Its explanation—The Bank rate—Its shortcomings—Some grievous misrepresentations—Dismantling of the Imperial Bank—Reconstituting the Imperial Bank—The Imperial Bank—Amendment Act and the future of the Imperial Bank.

Introductory.

The war no doubt brought to prominence many economic truths while it disproved some of the pet theories of economists. It left us quite a legacy of many difficulties, but it solved many important problems and opened the way for India to follow the practice of other countries, in having some sort of centralisation in banking matters. From 1807 [1] to 1919 the question of the formation of a Central Bank was mooted more than once but was never brought to the region of practical politics either due to the apathy of the Government of India or the provincial jealousies standing in the way of the amalgamation of the Presidency Banks. Not satisfied with the possibility of developing the Imperial Bank of India into a Central Bank the Hilton-Young Commission brought home to all parties concerned the utility of a Central Banking institution.

Amalgamation.

The present Imperial Bank of India [2] arose out of the amalgamation of three Presidency Banks of Bengal, Bombay and Madras.[3] Though not the first yet it was the most important one fraught with far-reaching consequences and pregnant with many possibilities. This amalgamation was quite a spontaneous thing being the result of a natural banking evolution in this country. The recent war amply demonstrated the weak joints in our banking armour and the results of a co-ordinated policy on the part of the various banks. Co-operation and co-ordination of policy for a short span of three years

[1] For the first proposal see R. Rickard's suggestion quoted in my book "Organised Banking in the Days of John Company."

[2] A brief history of the early proposals relating to the establishment of a Central Bank is given in Appendix II.

[3] A short history of the Presidency Banks is necessary for a correct understanding of the historical background. Hence their history is included in Appendix III.

in order to finance the requirements of war taught them the advantages of union, and the present amalgamation was only a consummation of that desire for they realised full well that there would be no true and effective co-operation without any formal amalgamation.[4] Amalgamation was synonymous with strength and anxious to retain the paramount influence which they wielded so long they entered into amalgamation so as to preclude any amalgamated banking unit of the London Money Market from obtaining foothold here and take advantage of the individual and isolated position of the three Presidency Banks. Alone and unaided no individual Presidency Bank would have withstood the strong and effective competition of the immigrant bank. As India stood in need of more loanable credit and as the woeful want of banking facilities in the interior of the country was a well-known thing this amalgamation strove to secure additional capital so as to extend banking accommodation and promote the healthy development of banking in the country. As some of the immigrant exchange banks were not British, foreign financial concerns might obtain undue influence and predominance in the monetary affairs of this country if the Presidency Banks were to remain isolated as before.[5] If a close union of British and Indian interests could be secured by the amalgamated bank and if it were to open a branch in London just like the Dominion banks of the British Empire a policy of co-ordination of finances of the Empire would become an accomplished fact.[6] Quite recently another link in this chain was forged

[4] Though the Imperial Bank Act was passed in September, 1920, the Imperial Bank began conducting business on 27th January, 1921.

[5] As in Canada there might be the American economic invasion and vast developments outside the influence of the British capitalists might take place. For an idea of the present situation see the special article in the London "Times"—Canada To-day—the American invasion—December 5, 1927, p. 15.

[6] It was in January, 1918 that Mr. Goodenough outlined the advantages of Empire Banking significantly in the following words :—"The extension of banking organisation and the maintenance of a fixed rate of exchange within the British Empire will give to our Dominions and Colonies a substantial preference and would serve to consolidate and promote trade with the Empire." A first-class practical expression of this policy from the Indian standpoint might be this amalgamation of the Presidency Banks and their access to London bringing about a close rapprochement between London and India. The present Barclay's (Colonial, Dominion and Overseas) Bank can be taken as an attempt to organise an Empire Bank with the object of co-ordinating imperial finances. The recent starting of the New Zealand Central Bank, the Canadian Reserve Bank and the Reserve Bank of India would complete the financial circle in the British Empire.

by establishing an advisory Committee to secure close liaison between the Bank of England and the Imperial Bank of India. In course of time closer contact would be established between the Secretary of State in Council and this Advisory Committee.

Constitution.

The total authorised capital of the Imperial Bank [7] is 11¼ crores of which half is paid-up and the other half forms the reserve liability. The paid-up capital consists of 75,000 shares of Rs. 500 each and Rs. 150,000 shares of Rs. 500 each of which Rs. 125 per share is paid. The reserve fund is Rs. 5,42,50,000 and the reserve liability of shareholders amounts to Rs. 5,62,50,000.

To guard regional interests and to provide ample freedom in banking matters the existing local Boards of the Presidency Banks have been retained. A Central Board is created consisting of a general manager or two managers in the first instance, the Controller of Currency as the *ex-officio* Member of the Board and the President and Vice-President of each local Board, the Secretary and Treasurer of each local board, who will have no voting power and four non-official members to be appointed by the Government to represent the tax-payer's interest.[8] The Central Board is created to settle disputes between the different local boards if any should arise, to look after the discount policy, to determine the distribution of funds, to fix the bank rate and to publish the bank's weekly statements. The Managing Committee of the Central Board meets more often and transacts business. Full provision has been made for the exercising of adequate control by the Government as the Controller of Currency has power to hold up any action of the Board on any matter of vital importance affecting

[7] The older institutions had on the aggregate Rs. 37,500,000 of capital and Rs. 34,500,000 of Reserve.

[8] Representation of new local boards may be added to the Central Board. There should be one local board instituted at each of the Clearing House centres—Rangoon, Karachi, Cawnpore and Lahore. It is a matter of gratification to note that the framers of the Reserve Bank selected Rangoon and Delhi also as centres of its branches.

either financial policy of the Government or the safety of its cash balances. The Government can call for any information regarding its affairs and can appoint any auditors to report on the accounts of the bank. Though it can be described as an all-India Bank possessing the largest number of branches, biggest share-capital and reserves. still the one peculiarity of it is the lack of any fixed location for the Central Board. Provision is made for its sitting alternately at Calcutta and Bombay. Judged by the experience of these eight years of its existence the Central Board has not succeeded in initiating any useful line of development. Under the 1934 constitution the Government representatives have been reduced to two only.

Business outside India.

The Imperial Bank has a branch in London to transact such business as may be entrusted to it by the Secretary of State for India, to rediscount bills of exchange for the exchange banks, to act as a custodian of such balances and to float sterling loans on behalf of the Indian public bodies. It is not allowed to take up the general foreign exchange business and compete with the exchange banks. While it is granted privilege to borrow money in the London Money market on the security of its assets it is prohibited from doing general banking business for all customers except the former ones of the Presidency Banks or its own customers in India. It has not been entrusted as yet with the task of floating and managing the sterling loans of the Government of India. From January, 1924 the London Office of the Imperial Bank has been entrusted with the duty of managing the Government of India rupee debt in London which was hitherto managed by the Bank of England.[9] Generally speaking the policy

[9] For doing this service the Bank of England was paid £ 500 per crore while the Imperial Bank is now paid only £300 per crore per annum with a minimum of £5,000 but if the balance falls below 8 crores in any one year this commission is to be reduced to £ 4,000. It also keeps the account of the High Commissioner for India in London. Since these lines have been written the R. Bank has been started. It manages the public debt and the High Commissioner's account also.

of the bank is to maintain practical equality of assets and liabilities at this branch. Quite recently an Advisory Committee has been constituted in London to guide the Imperial Bank's activities in the right direction.

According to the Act (Sec. 2 (*b*) of 1920) the Imperial Bank had to increase the number of its branches by a hundred more within a period of five years and the Government had the option of nominating 25 out of them in places of their own choice. At the present time (31st Dec., 1928) it has 200 branches [10] and the most important thing generally overlooked by the reader is its branch at Colombo. Although it is outside India proper there is no tendency on the part of the Imperial Bank to maintain a position of equality of assets and liabilities at this branch.

Business in India according to 1920 Act.

The Imperial Bank was given the free use of the Government reserve treasury funds and the balances of the Government of India and the local Governments. The Imperial Bank managed the public debt work.[11] It did not however perform all functions that the Bank of England now does for the Government of the United Kingdom. There is a separate public debt office which acts as the actual registrar of the debt. In the matter of floating rupee loans on behalf of the Government the Imperial Bank always took up a

10 Where it has no branch it has appointed agents to undertake collection business. Indigenous bankers, co-operative banks and joint-stock banks are appointed as its agents.

11 The following remuneration is sanctioned for this work. A commission of Rs. 2,000 per crore per annum on the amount of the public debt on the books of the public debt offices excluding (*a*) amount of loans discharged outstanding after one year from the date of the notice of discharge; (*b*) amount of currency investment; (*c*) amount of stock certificates for Rs. 5,000 and upwards held by the Controller of Currency; (*d*) the amount of stocks and notes outstanding in the London Register. The bank is further allowed a fixed sum of Rs. 2,000 a year on account of the stock certificates mentioned in (*c*) above. If the bank manages the debt work of the local Governments the commission is Rs 3,000 per crore. For managing the debt work of the Calcutta Port Trust and the Calcutta Corporation it receives Rs. 3,500 per crore. Besides this fixed charge it also levies Rs. 100 per crore of loans for management, transaction of the business and for printing charges.

big block of it and sold it over the counter to the public. Individual subscribers to the Rupee loans might apply either to the Treasury or the Imperial Bank. Subscription to the Government of India's Sterling loans were also dealt with on receipt of cabled advices from the bank's head offices in India.

The Imperial Bank transacted the same kind of commercial banking business which the Presidency Banks performed and some of its restrictions were only modified to a certain extent but their general nature was not in any way altered so as to permit unsafe business to be conducted. The following were some of the restrictions:—

"The Imperial Bank shall not make any loan or advance (*a*) for a longer period than six months, (*b*) upon the security of stock or shares of the bank, (*c*) save in cases of estates (Courts of Wards) upon mortgage or security of immovable property or documents of title thereof. The amount which may be advanced to any individual or partnership is limited to two crores of rupees only and this could be secured on security of trustee stock, Government security, goods or documents of title thereto. Discounts could not be made or advances upon the personal securities given unless such discounts or advances carry with them the several responsibilities of at least two persons or firms unconnected with each other in general partnership. It could not grant unsecured overdraft in excess of Rs. 1 lakh. The restriction of exchange business only to the *bona fide* requirements of its constituents however was a real practical limitation debarring it from a very profitable business. The other restrictions did not place very great disability on it. These did not seriously injure its profit-earning capacity and were of such a nature as could be safely imposed upon any other bank which aimed solely at the financing of internal trade, the marketing of crops, the movement of produce and undertook remittance business.

The banking business that it now transacts is of the following nature: (1) the receiving of fixed deposits,[12] (2) and savings

[12] These are of two classes: (*a*) those repayable at the end of 7 days' notice and (*b*) those repayable at the end of six or twelve months.

deposits,[13] (3) the collecting of deposits in the form of current accounts, the keeping of securities for safe custody, the buying and selling of gold and silver bullion and any other properties that might have fallen into the bank's possession in satisfaction of claims, the borrowing of money in India or London on the security of its assets, acting as administrator in winding up estates, transacting agency business on commission, the investing of its funds in authorised securities such as trustee securities, securities of Government guaranteed Railways, debentures, issued by the District Board and Government securities, the drawing, accepting, selling and discounting, buying and selling, bills of exchange payable outside India for and from or to such banks as may be approved, the issuing of letters of credit and bank post bills payable in India and in Ceylon, and lastly the drawing of bills of exchange and the issuing of letters of credit payable out of India for the use of their private constituents for *bona fide* personal needs and buying, for the purposes of meeting such bills, bills of exchange payable out of India at any instance not exceeding six months and the granting of advances in the form of loans, cash credits and overdrafts and the making of inland transfers from one branch to another on behalf of their customers. Thus it does general banking business like the commercial banks. Like the State Bank it acted formerly as the Government banker conducting treasury work at its branches free of cost and like the Central Bank of other countries it acted as the bankers' bank and all leading banks deposited their balances with the Imperial Bank [14] and it undertook clearing house work at the important monetary centres. It provided remittance facilities to the general public, the co-operative banks and the Indian Joint Stock Banks at slightly differential rates which were lower in the case of joint stock banks.

[13] The Imperial Bank pays 3% on ordinary savings bank deposits and 3½% on savings bank deposits of Rs. 10,000 and above fixed for three months. On account of the payment of interest the S. B. deposits increased from Rs. 412 lakhs at the inception of the bank to 1,029 lakhs on 31st March, 1925. These rates have been reduced in consonance with the reduction of rates in the money market.

[14] See Part I of Schedule I of the Imperial Bank of India Act.

The Balance-sheet of the Imperial Bank of India as on 16th March, 1928, can be taken as an illustration of its pre-1934 Business.

Liabilities.

	Rs.
Subscribed capital	11,25,00,000
Paid-up ,, ...	5,62,50,000
Reserve	5,12,50,000
Public deposits	6,01,40,000
Other deposits	71,30,29,000
Loans against securities *per contra*	—
Loans from the Government of India under Section 20 of the P. C. Amendment Act against bills discounted and purchased *per contra*	8,00,00,000
Contingent liabilities	—
Sundries	70,01,000
TOTAL ...	96,76,70,000

Assets.

Government securities	18,55,29,000
Other authorised securities	2,03,38,000
Loans	14,19,35,000
Cash credit	32,86,78,000
Inland bills discounted and purchased	14,01,17,000
Foreign bills	41,79,000
Bullion	—
Dead stock	2,78,66,000
Liability of constituents for contingent liabilities *per contra*	—
Sundries	38,03,000
Balances with the other banks	1,85,000
TOTAL ...	85,26,30,000
Cash in hand ...	11,50,40,000
TOTAL ...	96,76,70,000

The above balance-sheet includes:—

Deposits in London	£904,000
Advances and investments in London	990,600
Cash and balances at other banks in London	12,600

Percentage 13·37.
Bank rate 7%.

Explanation.

On the liabilities side the paid-up capital refers to the portion of the total capital on which the credit of the bank rests. It represents

the solid capital which the shareholders have paid up. The 'reserve relates to the reserve fund of the Imperial Bank. 'Public deposits are the deposits of the Government for which the Imperial Bank pays no interest. At the time taxes are gathered public deposits increase. 'Other deposits' are those of the Exchange banks, the Indian joint stock banks, the local Boards, the trust funds, the semi-public corporations, traders and the customers of the bank in its ordinary banking business.[15] These indicate the strength of the banking system.[16] The Imperial Bank does not pay on current accounts but pays interest on fixed deposits "on sums not below Rs. 500." "Loans against securities *per contra*" are usually borrowings of the bank against some of its authorised securities included in the assets-side of the balance-sheet. Loans from the Government of India under Section 19 A of the Paper Currency Act, represent sums borrowed on the internal bills of exchange or hundis drawn during the course of trading transactions in order to secure easiness of credit in the money market. With the starting of the Reserve Bank this item disappears automatically. "Sundries" means miscellaneous liabilities.

Coming to the assets side "Government securities" mean the Bank's investments in Government loans. "Other authorised securities" refer to the holdings permissible under the Act. The State-aided and District Board Railways, securities of the Port Trusts and the Improvement Trusts can be held and broadly speaking the proportion of the Government Securities to the total is approximately four-fifths.

Loans and cash credits refer to the Bank's advances to its customers on securities placed in its hands. It grants loans on the joint-stock securities of all kinds including debenture bonds and documents of title to goods in warehouses or transit. "Bills discounted" relates to the purchase of hundis and internal trade bills. Big loans are usually granted on gold both by the Imperial Bank and

[15] For a tabular statement of the total bankers' balances, see the C. B. Enquiry Committee Report, p. 21. This situation becomes changed as soon as the R Bank is started.

[16] An idea of the relative proportion between the two kinds of deposits can be gained by a study of Norman Murray's Evidence, Volume IV, pp. 479, (Hilton Young Commission; and see also Chapter III, The Central Banking Enquiry Committee Report.

the Exchange Banks. When the price of gold is fluctuating the speculative buyer of gold always counts on the possibility to sell the gold within the ten days that are usually granted for payment by the Exchange Banks which import the gold bars. If it is not sold in the market within this period a loan is negotiated and thus Indian banks usually lend on gold. Sometimes loans are granted to its constituents in London against securities held in India.

The Imperial Bank grants cash credits at moderate rates more generally at the prevailing bank rate to the provincial co operative banks. In this way the Imperial Bank is financing agriculture through the co-operative societies. The signature of two approved parties is insisted upon and the cash credit is extended to a period of six months.[17] The cash credit though not so self-liquidating as the trade bill is repayable at very short notice, say a week, and in effect a portion of these can come under the same category as trade bills. It is the practice of the Imperial Bank to curtail cash credit facilities or if it thinks that the stock of goods was going up during the past six months. Cash credits are granted usually against self-liquidating assets and not for locking up the bank money in securing fixed capital such as installation of machinery and repaying of capital debts.[18] Theoretically at least they are repayable on demand and can be called up at any time the bank wants to.

Sometimes 'manufactured bills' were substituted for the cash credits in order to place them in the P. C. Reserve and secure additional note-issue according to the provisions of the P. C. Act. But the Imperial Bank was decidedly against this creation of bills, for it was put to definite loss on account of stamp duty to be attached on the hundi at the rate of Rs. 9 per Rs. 10,000. Cash credits were granted to promissory notes bearing four annas stamp and the

[17] An overdraft account on the basis of a cash credit agreement is generally entered into with trading companies on the security of the pledge of goods and merchandise. In pursuance of such agreement the trading firms pledge goods and secure the needed finance from time to time.

[18] It occasionally lends on mortgage as primary security and initiates the loaning transaction when the primary security is a mortgage. See Mr. A. Bowie's Evidence before the Hilton-Young Commission (p. 102, Vol II). This is more an exception that proves the rule. As a matter of practice its loans are generally well-secured.

Imperial Bank had to pay the heavy duty to induce firms hitherto financing themselves by drawing bills. The Government had to agree to reimburse the Bank the cost of this duty for additional note-issue can only be obtained by placing hundis or issuing notes on treasury bills in the P.C. Reserve to a greater extent than it was compelled to do. Hence it was often arranged as a result of compromise between the Imperial Bank and the Controller of Currency to secure hundis and issue additional notes on the hundis.

" Foreign bills discounted " means the purchase of the foreign bills for its customers only and its sterling purchases average roughly about £6 sterling annually. The average maturity of the domestic bills would be about 60 days while the maximum maturity is 90 days Nothing definite can be stated as regards the average maturity of the overdrafts granted by the Imperial Bank.

" Bullion " refers to the gold and silver stock held by the bank.

" Dead Stock " refers to buildings, furniture and movable property owned by the bank. Balances with other banks are the accounts opened with other banks to facilitate collection and payment of cheques." Cash refers to the amount of cash in hand." This item is important and its proportion against the outside liabilities, *viz.*, the deposits, loans and sundries is expressed as percentage at the foot of the balance-sheet.

The Imperial Bank finances internal trade to a great extent and some of the big industrial companies are also financed by it.[19] The advances on hundi business are made to the shroffs who in their turn advance money to the outlying places. The Madras branch finances the Natukottai chetties who finance the Madras and Burma rice crop to a large extent and the trade of Burma with Ceylon, South India and Siam is in their hands. The financing of industries is usually done by (*a*) clean loans which are granted on pronotes signed by two persons and on a personal guarantee of some of the

[19] It should not be mistaken for the hundi rate for this is only the rate at which first class Hundis maturing at the end of 60 or 90 days are discounted for the shroff, by the Imperial Bank. The Imperial Bank hundi rate is again different from the bazar rate *i.e.*, at which the indigenous banker discounts the hundis. For a greater portion of the year there is a considerable spread between the hundi rates quoted by the Imperial Bank of India and the indigenous bankers or shroffs.

shareholders of the concern. This is how cotton-spinning and jute mills are financed. (*b*) Produce loans which are granted on country produce stored in the godowns under the bank's own lock and key. Sometimes the Imperial Bank may discount ' hand bills ' for approved customers and these are " pure finance bills." The Imperial Bank never finances growing crops except by means of granting clean loans on the personal guarantee of two persons. As a matter of practice the Bank advances on grain, produce, etc. These loans are usually made at 8 to 9 per cent. The agency work of the Imperial Bank consists in buying and selling securities on behalf of clients and receive goods for safe custody.

The Bank Rate.

The Bank rate indicates that the Imperial Bank is prepared to lend money on Government securities at that rate.[20] The bank rate is usually higher in winter and early spring ranging from 6 to 8 per cent. and low in summer say 4 to 5 per cent. On the whole the average rate is not high but it rises to high maximum during the busy season. When the demand for money is great the rate rises indicating that it is transacting considerable volume of business. During the slack season although the bank rate is nominally low it is willing to lend money at a still lower figure. With the starting of the Reserve Bank this significance of the Imperial Bank's rate disappears.

The most noticeable feature of the bank rate is that the Imperial Bank does not effectively control the money market just as the Bank of England controls the money market in London. Again the expected lowering and equalising of the extremely high rates that prevail for banking accommodation in our country during the busy season has not been realised. The ideally low bank rate of France or Germany or England has not been reached. Of course this is due to the Government borrowings either in the way of short-dated Treasury bills or permanent loans for longer period. Unless it gives up excessive borrowing there would not be the possibility of collecting

20 For an idea of the average bank rate see the C. B. Enquiry Committee Report on Chapter III, p. 27. The Statistical Tables relating to Banks in India would give us a good idea of the average bank rate.

surplus cash in the hands of the Imperial Bank and a lowering of the bank rate. Of late a more judicious policy in the matter of floating Treasury bills is being pursued and with a better understanding between the money market and the Government substantial benefits can be secured by both parties. The seasonal swings[21] for currency are no doubt responsible for reasonable fluctuations in the bank rate, but still the prevailing high rate of discount is chiefly due to the insufficiency of capital in the country. The difficulties of the cold weather finance during any year generally arise solely if the exports such as jute, hessians and cotton are to be sold at a high price and great funds would be required to move the export crops to the ports. Whenever crops move in their streams and the produce is low-priced there would be no tightness in the money markets. When trade is brisk, crops are heavy and the produce is high-priced there would be tightness of money in the market. Interbank call money rate would rise. The percentage of the Imperial Bank's cash reserves would fall. Exchange itself would become lively and the different financing agencies get brisk business. Bank rate has to be screwed up. If at that time the political situation in this country continues to be disturbed it would act as a bar to the free export of capital from the United Kingdom to India. The creation of the Reserve Bank and the extension of re-discounting facilities would soon change the situation but it behoves the governing authorities to discern the trend of the financial conditions in the country and make suitable adjustments in the bank rate.

Expected Advantages.

Though the glorious vision of a great State-bank [22] subserving the interests of the public and rendering equally meritorious service to the other banks doing business in the money market, which Sir M. Hailey invoked was not realised and though it has sometimes

21 During the marriage season, holiday season and Holi season there is a great demand for currency.

22 See the Government Despatch to the Secretary of State for India on the Imperial Bank proposal.

discriminated against Indian interests in certain cases [23] yet certain advantages have flown out of its actual working during these years.[24]

The General Public.

The general public were benefited much by the popularising of the banking business. The opening of branches of this quasi-Government bank with its single and unified management inspired confidence among the public and inculcated the banking habit gradually. Though there may be no sudden miracle brought about by the creation of a banking habit yet it is an indispensable preliminary for making people believe in the utility of the banking institutions.

The staffing of the innumerable branches of the Imperial Bank required men trained in the methods of banking and this stimulated very considerably the training and employment of Indians as bankers. Thus a banking career was created within a short time and it did afford some relief to the already overcrowded professions of the present day. More of these sound and trained bankers may lead to an improvement in the banking standard of our country. Some of these trained officers have been lent to the Reserve Bank.

The Customers of the Bank.

With the fuller utilisation of the Government balances and a more elastic use of them and with more increased working capital the Imperial Bank could indeed reduce the high discount rates which generally prevailed during the busy season.

The opening of a branch office in London has led to closer touch with the London Money Market which is the well-known hub of international commerce. The obtaining of trustworthy information regarding English trading customers could be easily done. The arranging of sterling loans for local bodies could be easily accomplished and investments in international securities could be effected. With a largely increased number of branches it could discount more hundis and traders' bills thus irrigating the channels of internal trade.

[23] See Mr. T. C. Goswami's Minute of Dissent attached to the External Capital Committee's Report, p. 24.

[24] See his speech in the L. Assembly on the I. Bank Bill, September, 20.

The Government.

The Government gained much by a successful working of the bank. Millions of rupees locked up in the Reserve treasuries usually caused a tightness and stringency in the money market.[25] The Imperial Bank transformed these immense balances from mere warehouse merchandise into an active banking power. The Government has discontinued the issuing of currency transfers to the public between any two places in which a local head office or branch of the Imperial Bank is situated. The Imperial Bank transfers its funds through the currency chests free of charge and in return has undertaken to give the public every facility for the transfer of money between the local head office and branches at rates not exceeding a maximum approved by the Controller of Currency.[26] Becoming responsible for the movement of funds and making them available to the Government whenever and wherever they were required the Imperial Bank had to soon open more branches. As the Reserve Treasuries which hitherto acted as a buffer receiving the first shock were abolished the Imperial Bank had to keep higher proportion of cash to liabilities so as to suit all sudden and large demands. This concentration and pooling of reserves had its own salient effect in leading to efficiency and economy of the reserves and adequate business accommodation.

The decentralisation of the public debt work greatly improved the administration of the public debt. The small investors have been now going in more freely for Government securities than it used to be the case formerly.

25 This can be illustrated from the Bank of Bengal's rates of discount which were altered according to the cash reserves of the bank and the demand for discount.

Year	Minimum	Maximum	Year	Minimum	Maximum
1877	7½	14½	1883	7½	10½
1878	5½	11½	1900	3	8
1879	6½	11½	1907	3	9
1880	5½	9½	1910	3	6
1881	5½	10½	1912	3	8
1882	6½	12½			

26 For the rates approved see the Report of Controller of the Currency, 1920-21, also Appendices X and XI attached to the memorandum submitted by Mr. A. C. McWatters to the Hilton-Young Commission.

With the sole aim of freeing the Secretary of State from the carping criticism of the unenlightened public the banking and remittance business was proposed to be entrusted to the London branch of the Imperial Bank. But no substantial gain accrued under this heading. Even the floating of sterling loans in London was still entrusted to the Bank of England.

The Imperial Bank.

The Imperial Bank has been enjoying the proud and privileged position of a banker's bank. Securing a united stand of European as well as Indian businessmen the Imperial Bank shouldered the extension of banking facilities to the interior. With increased resources and Government backing behind it was expected that it would become a sanctuary for the struggling banks. Enormous capital and massive size would enable it to secure controlling influence and act as the recognised and responsible leader. Conducting sound banking in times of stress as well as ease it was expected that it would create a sense of security and confidence in the minds of the public. Access to the London Money Market was granted and many of its older restrictions imposed in 1876 were relaxed.

The Joint-Stock Banks.

The Imperial Bank was expected to be their guide, friend and philosopher rediscounting their bills and satisfying their wants for more credit currency. Apart from being well prepared to withstand a domestic crisis it was earnestly hoped that the Imperial Bank will be an effective protection against foreign influences. Besides welding the banking system into a co-ordinated whole it would tend to secure greater stability of business owing to greater activity and mobility of reserves administered by it and the outlying banks would have sound protection which would be more than a set-off to any diminution of their profits.

Exchange Banks.

Coming to the exchange banks it can be confidently predicted that they will reap their own share of common prosperity. Now that

competition in general exchange business has been eschewed no real ground for resentment can exist. Their bills will be rediscounted in India, thereby enabling them to send back money to London quickly, and be in a position to make further purchases of import bills into India.

The Co-operative Banks.

The co-operative banks will gain much by the successful working of the Imperial Bank as the rediscounting of agricultural bills might be taken up by it. Acting as the central rediscounting agency and armed with the privilege of note-issue it was expected that greater finances could be placed at the hands of commercial, industrial and agricultural interests.

Overcoming inter-provincial jealousies, securing capable men to act as directors and creating different independent local boards to look after the regional interests of the country it was expected that the effectively controlling Central Board of the Imperial Bank greatly aided by Government help and soundly advised by the Controller of Currency would function successfully. Securing independence of banking power at all costs the Imperial Bank was expected to work miracles in the unorganised banking system of the country. As the common adage puts it " the occasion as well as the hour would bring forth the man," *i.e.*, give the Imperial Bank a glorious opportunity to become "a full-fledged Central Bank" as its sponsors said. But "it was opined that these results would flow if only it realised its duties." It has to bear in mind that "a central bank is a great note-issuing institution in which is vested to an extraordinary degree the financial responsibility of a nation in that its methods enable it to supply at all times an elastic currency varying automatically with the needs of the country, to maintain an adequate gold reserve through the regulation of foreign exchange and to conserve and protect the country's metallic reserves, to control the money market by its regulation of the discount rate and to serve as a sanctuary for all banks in periods of threatened danger." The task of watching the general stock of gold and the repressing of the tendencies towards an undue expansion of credit and expanding currency so as to supply the needed amount to meet the demands of trade, are some of the functions and onerous duties performed by the

national banks of foreign countries. *The Imperial Bank should realise that as a national bank it has to keep an eye on national interests.* It should not be a purely profit-seeking institution. It should protect and safeguard the general financial situation of this country always. In order to become a Central Bank it has to make these necessary sacrifices. It should not compete with other banks. If it were to do so with its far larger resources and special privileges from the Government it would incur their resentment and hostility. It should on the other hand be their refuge in times of panic and trouble.

Its actual achievements

While such were the advantages that were actually expected out of its successful functioning it is the duty of the bank historian to record its actual achievements. What can indeed be considered as a memorable achievement lies in the transformation of the Indian Money Market rates which the amalgamated Imperial Bank succeeded in bringing about. The different rates, *i.e.*, the Imperial Bank Hundi rate and the Bazar rate have been much reduced and at least in the Bombay Market it is being systematised Next, whereas before the amalgamation there was a differential between the Madras Money Market rates and the Bombay and Calcutta money rates these irregularities have been ironed out and levelled. And lastly whereas before the amalgamation the seasonal swing of business carried with it correspondingly sharp fluctuations in money rates throughout the year these have been reduced and a new elasticity in the credit system has been obtained by the seasonal expansion of emergency paper currency according to the terms of the P. C. Amendment Act, 1923, and subsequent changes in the procedure through its channels. This reduction of rates by itself is a notable contribution which the Imperial Bank has rendered to the business stability of this country.

Opening its branches in the interior of the country it is slowly expanding its field of usefulness and is bringing within easy reach of all sound banking facilities. The Imperial Bank recently opened a large number of pay offices during the first half of 1927 in the grain districts of the Punjab and the United Provinces. This shows that the Imperial Bank is alive to the necessity of progressive expansion

without any direct Government pressure being exerted in favour of branch development and several of them are established in places where banks or branches of banks do not exist. Since the liquidation of the Alliance Bank of Simla the Imperial Bank has been trying to cover some of the abandoned ground.[27] It is thereby able to finance movements of agricultural produce and internal trade. Inland exchange and remittance operation are also performed satisfactorily. The present-day policy is to consolidate and strengthen the existing branches rather than open new branches.

It exercised an " imperial outlook " and wide latitude of vision when it promised to help the Alliance Bank of Simla but the evils were too deep-rooted to be remedied. Its help to the creditors of the Alliance Bank of Simla was undoubtedly due to the initiative of the Government of India and it cannot be taken as a precedent that would be followed in case of all bank failures. It did nothing to save the depositors from the disaster arising out of the failure of the Bengal National Bank. But it has always acted as a sanctuary to the troubled banks in times of a "run." When the Alliance Bank of Simla was closed there was a run on the Tata Industrial Bank and the Bengal National Bank.[28] The Imperial Bank promptly assisted them. Similar help was given to the Central Bank of India when there was a run on its Bombay and Calcutta offices during 1926. It acted as an element of strength to these banks during the hour of their trial.

Cheap remittance facilities are being granted to the banks. Merchants and traders are making increasing use of the improved facilities for internal remittance. The transfer of money from its local headquarters to its branches was effected at rates fixed by the Controller of Currency which were originally one anna for amounts of Rs. 10,000 and over. Owing to reduction in these charges an increasing use is made of such facilities. Before long a day may arise when there will be no charge made for internal remittance through the agency of the Imperial Bank.

27 See the Evidence of Mr. A. Bowie before the Hilton-Young Commission

28 See Mr. B. Chakravarty's speech at the Annual Shareholders' meeting of the Bengal National Bank, held in 1923. See also his oral evidence before the Hilton-Young Commission, Vol. IV, pp. 392-400,

The Imperial Bank has developed close relations with the apex Provincial Co-operative Banks of the different Provinces and cash credits and overdrafts are allowed on the deposit of sound security. Ordinary joint stock banks also maintain close relations with the co-operative banks as in the case of Germany [29] and Italy. Until such close relations are maintained it would be impossible to make adequate provision for all the credit requirements of the agriculturists. The granting of free remittance facilities to these as in the case of other joint stock banks would be widely appreciated. The bills endorsed by approved indigenous bankers are freely purchased by the Imperial Bank, up to certain agreed limits. Loans are given to them on demand promissory notes bearing two names. The discount rates for hundis have been lowered in many centres.

It again launched out a bold policy of helping the Indian small and middle class investors so as to enable them to subscribe to the 1928 rupee loan floated by the Government of India. As eighty per cent. of the loan subscription is to be paid by the Imperial Bank of India on behalf of the customer-subscriber the customer would be getting a Government bond carrying 5 per cent. rate of interest and as he would be paying four and a half per cent. on the loan amount to the bank, the real rate of interest to the subscriber would be nearly half per cent. on the actual money he loans to the Government through and with the help of the Imperial Bank.

The policy of the Imperial Bank is to have a stock of securities ready for sale over the counter at all its branches. It also facilitates the buying and selling of securities for its customers and the investment habit is thus encouraged to a great extent.

Its Shortcomings.

Nevertheless if we push our investigations a little deeper so as to penetrate behind this attractive and imposing facade a different condition of affairs begins to reveal itself. It was expected that the Imperial Bank would rise to the full dignity and stature of a Central Bank.

29 The Dresdener Bank acts as an apex bank for the powerful Schulze-Delitzsch unions and the agricultural unions based on the Raiffeissen principles. It maintains a separate co-operative section to conduct this business

Writing in 1925 I advised that "it should be acting as the depository of the cash reserve of the other banks, performing more business with the banks than with the outside public thus justifying in reality the term bankers' bank relaxing the loaning policy to some extent, realising that it is the handmaiden of trade and industry of our country whose imperative duty is to fulfil its ever-changing requirements, caring less for profits than is the case at present, developing to a certain extent the newly permitted acceptance business, organising a discount market and rendering help to all sound banks in their occasional hours of distress, the Imperial Bank can obtain real control over the money-market and uninfluenced by political currents or other members of the banking community it should conduct the whole machinery of banking in the wider national interests of the country." It was a complete disregard of this advice that has led to a scathing indictment of the Imperial Bank's policy.

On the banking side the Imperial Bank does certainly compete with the Indian joint stock banks and it has always been a bitter source of complaint on the part of the joint stock banks.[30] The general public however stands to gain out of competition between these banks in its fuller form. The breaking down of the semi-monopolistic position of the joint stock banks is a distinct advantage by itself.

It has not done much in the direction of training Indian apprentices [30a] to responsible offices as it continues to be an "entirely European-controlled and European-managed institution." Though invidious racial discrimination [31] does not exist the tabooing of all questions relative to the Imperial Bank's management by the members of the Legislative Assembly has rightly or wrongly created

30 See the oral evidence of Mr. A. Bowie before the Hilton-Young Commission, Vol. IV, p. 93 : "Placed above economic competition by virtue of its character as a quasi-state bank" it has begun to compete with the indigenous joint stock banks that have been left powerless to withstand this competition. The exchange banks are however free from this economic competition on the part of the Imperial Bank." For contrary view see the oral evidence of witnesses representing the Bengal Chamber of Commerce before the Hilton-Young Commission

30a Mr. N. R. Sircar corroborates these remarks in his Minute of Dissent, the C. B. Enquiry Committee Report, p. 525.

31 See Chapter XVIII, C. B. Enquiry Committee Report, p. 373.

suspicion against the Imperial Bank. The huckstering spirit in which the bargain is made that if the Imperial Bank of India were to be the sole agent of the Reserve Bank *no non-Indian* should be appointed has to be deprecated. The time is come when a fully Indianised staff alone can be made economical and efficient at the same time. The majority of the directors should be Indians. No further recruiting of non-Indian officers should take place except in special cases.

The racial and political discrimination in the matter of granting loans has been often referred to. No attempt has been made to silence this grievance effectively.

Its partiality towards non-Indians has once again been raised.[31a] It is natural that the non-Indian staff would sympathise liberally with the non-Indian borrowers.[31b] That greater line of credit is often granted on the same kind of security is the main grievance. This can only be removed when local committees of Indian businessmen advise the bank in the matter of distribution of its advances and loans to trade and industry. It is their absence that is responsible for the increased investment made by the Imperial Bank and it is the Government that is reaping the main benefit from the expansion of the Imperial Bank's activity.

Again it has failed to create a powerful body of private banks round it. One of the objects of the amalgamated bank was to create "*a central rediscounting agency.*" But there are not very many bills drawn even now and an open discount market does not exist where the bill can be borrowed upon. Nothing substantial has been done in the perfection of this most important form of negotiable credit.

There has been a closer rapprochement between the exchange banks and the Imperial Bank while such cordial relations are not established with the joint stock banks.

Nextly, the percentage of cash as against its liabilities falls to a dangerously low proportion and often for several weeks the proportion would be 12 to 15% and the rigidity of our credit structure becomes too apparent at such times.

[31a] See the evidence of a Madras witness before the C. B. Enquiry Committee.

[31b] C. B. Enquiry Committee Report, p. 377, Vol. II.

The present policy of subsidising the Imperial Bank to open more branches is too costly and would have to be continued for a number of years if these branches are not to be closed. Many of the branches tend to drain away money so that financing of trade is greatly handicapped.

In some places the Imperial Bank has not adopted the salutary practice of appointing local people to help the branch managers in the matter of discounting bills. The Lucknow branch of the Imperial Bank would have avoided such loss if it had been helped by such a local Advisory Committee. Even now it is not too late to mend matters. In all important centres of trade the institution of such bodies is a desirable step in the right direction. T. Joplin [32] pointed out the advisability of this step long ago and recommended the placing of every branch under a board of local directors chosen from commercial and industrial people of the locality.

The top heavy administration of the bank has not been rectified. Non-Indians man the superior staff though it has to be admitted that Indianisation of the staff is proceeding apace.

Finally, it failed to rise in opposition to the Government when it was undertaking functions in disregard of the general interests of the country. This has arisen chiefly out of the fact that there is no element of *national control* either in the matter of *shareholding* or management. Mr. Gubbay one of the fathers of the amalgamation scheme, says that "one of the possibilities I had in mind when this was created was that *the Finance Department of the Government of India should be strengthened by being able to say in regard to any suggestion on question of banking or finance or exchange or currency from outside that they had the control and regulation of the financial arrangements in India.* I said to them: It is bound to occur that the Governor and the Managing Governor of the *Imperial Bank will have to stand up to the Government if they think that the Government are taking steps which they regard as likely to endanger or to be inimical to the general requirements of the country.* I say of that

32 See "An Essay on the General Principles and Present Practice of Banking in England and Scotland," by T. Joplin. The Big Five of London keep consultation Committees of former directors of amalgamated banks to grant advice to branch managers.

function of the Imperial Bank I have seen no evidence whatsoever that it has been or is being discharged.[33] It never enabled the Government to develop a current policy in encouraging the use of hundis and internal bills of exchange. Its volume of cash credits has expanded while that of bills discounted has diminished. A bill market has not been developed as yet.

A grievous misconception that is prevailing in the minds of the general public is that the state is not exacting any *quid pro quo* for the deposits it is entrusting into the hands of the Imperial Bank of India. The grievance is that the state does not participate in the profits of the bank arising out of the banking use of its deposits by the Imperial Bank. The services that the bank is rendering are very often forgotten in this direction. The Imperial Bank does the Treasury business which entails heavy work and a good deal of expense. The prestige of its being the sole agent of the Reserve Bank indirectly attracts deposits.[34] It is inevitable that one bank or another should be selected and although the selected bank should pay something in return for the free use of State balances too unfair use is being made of this single argument. Restrictions interfering with the work though not the policy of the Imperial Bank have been laid down. The bank is entangled in somewhat fantastic statutory provisions.

It is undoubtedly true that it has tended to become a *State Bank* in the narrowest possible meaning of the term. It has failed to become a *genuine Central Bank* cheapening credit and commanding due respect

[33] Even in America there are many people who are questioning the ability of the F. R. Banking system to control credit Even there it is admitted by experts that it has not proved a complete success and there are some who have already pledged themselves to see that the F. R. system should be abolished or radically changed. But the charter has been indefinitely extended and the 1933 Glass Steagall Act attempts at including all State banks in the F. R. Banking system. The aim of dispensing with too many local banks independently creating credit is the definite ideal placed before the public. See the Glass Steagall Act of 1933, U.S A. or the Measure for banking reform proposed by Senator Aldrich (1933). See George Peel, ' The Economic Impact of America,' pp. 303-309.

See the evidence of Dr. Sprague before the Stabilisation Committee, House of Representatives, 1895-1927, pp. 403-413.

[34] The Imperial Bank certainly secures a decent return out of the use of the State balances. It is also true that a large part of the working capital of the bank is due to the cash balances of the State.

from all parties. It has been handicapped however in this important respect by its own charter. The two serious limitations are lack of control over the issue of paper currency and lack of power to deal in general foreign exchange business at least to facilitate the remittances of the Government of India from India to England. If once it loans up to its full limit during the busy season it has no further power to expand the currency beyond the twelve crores limit. Hence arises its failure to cheapen credit during the busy season. Now that the Reserve Bank has been created all these difficulties would be removed in course of time.

The dismantling of the Imperial Bank.

It has been suggested that the Imperial Bank of India should be dismantled and in its place a new organisation based on the model of the Federal Reserve Banking system of the U.S.A. should be started in this country with the Reserve Bank as the Central Bank and pivot of the whole banking system. It is proposed to dissolve the Imperial Bank and revive the old Presidency Banks in the Presidency cities without branches in the interior. Below them district banks should be created in each district and all these three constituents should be federated into an entire structure. While the Reserve Bank should be the Imperial Government's banker the Presidency Banks would obtain the work of the Provincial Governments and the District Banks the work of these governments in the moffusil areas and all Government treasuries should be abolished. Lest Government funds might be mismanaged it is proposed to make it compulsory on the part of these banks to deposit a certain amount of minimum funds to promptly repay the Government balances. Such local banks dealing with local needs would enable the flow of capital from province to province, when the bank rate of the latter rises. Diversity of economic conditions and trade requirements necessitate the maintenance of separate rates for the different parts of the country and one uniform rate all over the vast continent as is now maintained by the Imperial Bank is positive discouragement to the free flow of capital from one province to another.

Although there is some amount of truth in this criticism yet the maintenance of a federal system of banking would not be the panacea for our banking ills. This scheme is fraught with certain dangers. The rights and privileges of the shareholders of the Imperial Bank would have to be udly safeguarded. It would introduce great disturbance in the money market. The management of the different district banks might not be conducted on sound lines. The Reserve Bank's voice might not be immediately felt throughout the banking system. A scientific credit control or the joint control of credit and currency would then become impossible. It is not mere numerical increase of banking institutions that is the chief desideratum at present. The whole swarm of the District Banks might pursue " a liberal policy " of expansion as they would be susceptible to the pressure of making profits.

Decommercialising the Imperial Bank.

Sir Osborne Smith evidently has the idea of raising the Imperial Bank to the full status of a Central Bank so that the problem of reconstituting the Imperial Bank would resemble a great office building changing its antiquated structure and substituting in lieu thereof steel and marble yet accomplishing it all without serious inconvenience to its tenants Though this reorganisation of the Imperial Bank can be brought about thus eschewing the vexed questions of securing the required constitution and the directorate of the Central Bank it is nothing but an inadequate appreciation of the results that makes possible this ill-considered agitation for reorganising the Imperial Bank. Even granted that all practical difficulties in reorganising the Imperial Bank are successfully solved and that the shareholders of the Imperial Bank agree to the limitation of dividend, and remain content with a

[35] See the Economic Journal (London), September, 1928—an article on "the Indian Reserve Bank," p 413.

[36] See H. L Reed, " The Development of the F. R. Policy."

subordinate role of acting as mere consultants in the management of the reorganised bank and that the control and supervision of the Government is happily superimposed, it does not immediately follow that the new organisation would meet with success.

Without ample financial resources and without any public confidence the Imperial Bank exists at present unable to pursue any bold and energetic policy. So it is proposed to make it a dominating Central Bank by rectifying the major defects. Note-issue would be handed over after making due provision for its elasticity by the employment of a graduated tax on deficient reserves. The note-issue would be based on the general commercial assets of the bank rather than on its holding of Government securities. The necessary staff would be lent to the Imperial Bank and it would facilitate matters and ensure good management of the note-issue from the beginning. Centralised control and protection of public interest would be also secured. Free transfer of funds in India would be allowed to other banks. No more branches would be established in future in such places where other banks or their branches exist. Even at the existing branches of the present time dealings would be confined solely to banks and competition would be eschewed altogether. Rediscounting can be easily allowed by the Imperial Bank by virtue of its added strength, namely the note-issue. With proper facilities for the encashment of notes and a proper provision of sufficient coin and bullion and other liquid assets to act as a secondary reserve, the reorganised Imperial Bank can provide the needed accommodation in our money market. Managed with economic foresight and a correct appreciation of the Indian situation the Imperial Bank of India can be made to play the role of a Central Bank or an apex bank assisting other banks.

But there are certain disadvantages arising out of this scheme. As earnings must be large enough to maintain the present rate of dividend and maintain the prestige of the Imperial Bank in the eyes of the public, a liberal use of its funds would be necessary. As one eminent banker says, "earnings constitute the gauge of success applied by a large section of the public including many bankers. It is characteristically human to uphold the successful enterprise and to obstruct the unsuccessful. A small percentage or reserve coupled with unqualified approval will constitute one potent power of support than

larger reserves with loss of popular confidence. In order to exercise powers of credit control the Imperial Bank must have some funds invested—the withdrawal or release of which would exercise a beneficial influence. It is not emergency relief alone but continuous operation on a scale to maintain the present rate of dividend which would be essential. Even if this takes the shape of too frequent rediscounting it might easily lead to an expansion of credit. Another danger would be that its funds would be used by the rediscounting banks and the ability to act promptly in times of disturbances would be checked. To cover even the bare operating expenses of the Imperial Bank with its present number of branches would require huge return and constant employment of funds either through rediscounting (and we have already seen the dangers of these steps) or by its open market operations and direct relations with the trading public in which case the cry of " uneconomic competition " would be easily raised by the Indian joint-stock banks. It cannot avoid in this case becoming an active competitor with other banks. It is one of the established orthodox tenets that a Central Bank should not compete with its " constituent " or " member " banks. Manipulation of currency in its own interests might be the charge levelled against it. The combining of commercial and central banking functions might lead to the imposition of very heavy and onerous burden on the Imperial Bank. It might fail to perform either task efficiently.

The fusing of continuous commercial banking operations along with that of the national duties of the Central Bank is theoretically impossible and practically dangerous to the existence of the Central Bank itself. At crucial times it would either have to sacrifice its commercial operations or forget the national responsibilities of maintaining a sound currency and credit machanism of the country. It will not be " proof against the possibility that the discharge of its duties towards regulation of the currency may be affected by its interest as a trading organisation working for profit." An 'impartial harmonisation'

[37] As many as one-fourth of the national banks of the U. S. A. are " deposit banks." Even the Midland Bank has been raising the propriety of making the Bank of England the sole bank for conducting Government business.

of the two diametrically opposite duties cannot be secured. Even supposing that both God and Mammon can be served equally faithfully there will be a strong reaction on the banking progress of the country by reconstructing the Imperial Bank as a Central Bank of Issue. The recent Royal Commission on Currency argues that the Imperial Bank should extend commercial banking facilities and so two banks are needed. The existing banks can be subsidised to undertake commercial banking under proper safeguards. Hence this argument cannot be considered as the sole or the most important one against the decommercialisation of the Imperial Bank.

The 1934 Imperial Bank Amendment Act.

The Imperial Bank becomes a fully commercialised bank freed from all vexatious control. Firstly, it becomes the sole agent of the Reserve Bank for conducting Government business— although such a practice is against the traditions of other countries.[38] The 3rd schedule of the R. Bank Act states the terms of the contract and remuneration proposed for this business [39] and the terms concerning the subsidising of the branches of the Imperial Bank in the first fifteen years[40] of the contract by the payments of following funds according to a schedule. About 20 lakhs would be granted to the Imperial Bank during the course of fifteen years.

38 The main advantage of such a step is to give the scheduled banks good prospects of future development and it assures them of a settled position. The attendant disadvantage of Government funds being lent at different rates by competing banks would ensue and if there are too many depositaries it is likely to react adversely on the standard of banking. The advantages promise to outweigh the possible disadvantages and for a few years this practice has to be carried out under proper safeguards.

39 On the principle that " banking facilities like bakers' bread ought to be brought to the doors of the customer " there ought to be an extension of similar facilities to other joint-stock banks desirous of extending these branches.

40 *Vide* the *Statist*, November 8, 1930, p. 705.

Secondly certain limitations on the business of the Imperial Bank have been removed. (*a*) The London office can now transact any kind of business. It would conduct commercial banking and can undertake exchange banking business at the same time. (*b*) It can open branches outside India in London and elsewhere. (*c*) It can conduct more freely internal banking business than before. It can lend or grant cash credits on shares of the Reserve Bank, upon debentures issued under the authority of a Local Legislature of this country, Municipal Board, or ruler of Native States with the sanction of the Governor-General in Council. It can lend on goods hypothecated to it as security. It can lend for nine months for financing seasonal agricultural operations. It permits the bank to hold movable and immovable property as security for any loan or advances. (*d*) It can borrow money outside India for conducting its business. (*e*) Instead of four managing Governors appointed by the Government to the Central Board only two will be appointed to safeguard the interests of the Government. The Government can also appoint an official of the Government to attend meetings of the Central Board and watch its proceedings. This obviously leads to the loosening of the strings of control. (*f*) The Governor-General in Council can appoint auditors to examine and report on the affairs of the bank in case of necessity. (*g*) Regulation 54 of the Old Act of 1920 has been removed altogether in the new Act and this means that the Governor-General in Council will have no power to call for any formation or insist upon the publication of its assets and liabilities in whatever form he may desire it.

From April, 1935 the Reserve Bank took over Public Accounts of Public Debt offices and Government Currency offices. So that two significant items have disappeared in the new balance-sheet of the Imperial Bank. Public deposits and ways and means advances have disappeared once for all. Similarly "Loans for Government of India under Sec. 20 of the P.C. Amendment Act" will never more figure under the liabilities side. Significant increases of loans and cash credits have taken place enabling the Imperial Bank to maintain a dividend of 12% free of income-tax. Executor and trustees departments have been established at the local head offices. A glance at the new balance-sheet issued under the new constitution will enable one to realise the change.

Balance-sheet—June 30, 1935.

Liabilities

	Rs.	A.	P.
Authorised capital	11,25,00,000	0	0
Called-up capital	5,62,50,000	0	0
Reserve liability of share-holders Rs. 375 per share on 150,000 shares 5,62,50,000			
Reserve fund	5,42,50,000	0	0
Fixed deposits, Savings bank current and other accounts	72,43,09,364	2	11
Loans against security *per contra*	...		
Acceptances for constituents	...		
Dividends for half-year and unclaimed	38,27,136	14	3
Profit and loss accounts	32,27,595	14	5
Rs.	84,18,64,096	15	7

Assets.

	Rs.	A.	P.
Investments	37,83,28,194	12	9
Advances	26,82,07,815	11	10
Dead Stock	2,34,94,931	12	2
Sundries	8,39,328	6	8
Adjustment account of interest and commission ...	33,83,864	0	4
Cash in hand and with the Reserve Bank of India and other banks	16,26,14,962	3	10
Rs.	84,18,64,096	15	7

Section 45 of the Reserve Bank Act, insists upon the Imperial Bank's always maintaining a sound financial position so long as it acts as the "sole agent" of the Reserve Bank for securing Government funds.

This new contract is not only decidedly better than the 1930 terms but it is elastic enough to permit the reduction of the remuneration and confine it to actual working expenses to which the Imperial Bank might be put to. Economy forms the keynote of the new contract. A gradually declining amount of subsidy for maintaining existing number of branches is also granted.

The future of the Imperial Bank.

The 1934 Amendment Act has removed many of its irksome features and would undoubtedly increase the driving force of the Imperial Bank in the banking system of the country. Should it be directed towards branch extension in the country or depriving the Anglo-Eastern Exchange Banks of the monopoly of financing India's foreign trade? Can it become a major industrial bank financing the existing industries and thus provide long-term requirements? As there is no use of combining all these functions in one and the same hands these several alternatives have to be discussed in an intimate manner.

As an Exchange Bank.

With a London office and offices abroad in other countries free to conduct commercial banking exchange business would naturally be thought of. The technique of exchange banking is not difficult for it to master. As it has best experts in its hand and branches all over the country it would prove the most formidable competitor to the existing exchange banks. But exchange business is being already satisfactorily discharged by about 19 banks who are finding it difficult to maintain their existing rate of dividend as a result of excessive

competition amongst themselves. The advent of the Imperial Bank into the ring would make matters worse. Nobody knows the exact strength of the Indian shareholders of the Imperial Bank. Granted that it is about 55% it clearly follows that the Imperial Bank would soon join the ranks of the exchange banks. When it attracts the London deposits as do the present exchange banks it would be London money that would be financing our foreign trade. The main problem of conducting the financing of foreign trade with domestic funds would be defeated. It can easily fraternise with the existing exchange banks. At present there is a lot of dissatisfaction at the treatment meted out to the Indian customers by the foreign exchange banks. As a member of the same association the Imperial Bank would undoubtedly continue the best traditions of these exchange banks.

As a major industrial bank.

It must be remembered that as the Central Bank is started with branches at the regional centres such as Delhi, Rangoon, Bombay, Calcutta and Madras the bulk of the Government money would be withdrawn. The clearing accounts of the scheduled banks would be withdrawn as the Reserve Bank would be undertaking clearing or settlement business.

Becoming an ordinary bank it would have to pay fixed deposit accounts at rates which the other competing banks are paying. The maintenance of branches and the necessity to pay the depositors point out that its success would depend on a constant and steady turnover of its capital resources. So the suggestion that it should be converted into a big Industrial Bank of a regional character to enable it to diversify its industrial loans and spread the risk involved in the business on a business like basis is not based on sound reasoning. Non-terminable loans and continuous locking up of capital for a lengthy period would reduce its turnover of capital. It would be unable to maintain the existing rate of dividend to the shareholders. It would require a lot of inequitable sacrifices on the part of its shareholders. After all it is not the lack of financial resources or facilities

alone which are standing in the way of the industrial progress of this country.

As a premier commercial bank.

Acting as the chief provider of short-term capital for the co-operative banks and holding the debentures that would be floated by the provincial land mortgage banks as part of its investments, it can easily afford to continue its present commercial character which does not however preclude it either from financing the existing industries in which it might have confidence or conducting exchange business to satisfy all the requirements of its existing customers. But it must bear in mind that it should not be saddled with heavy external deposits attracted elsewhere. The collection of these heavy external deposits for use in this country might cement the financial ties between London and this country but this policy needs very judicious lending on the part of the Imperial Bank. London deposits might be lying in its hands for a long time but this must be covered sufficiently by quick London assets. Heavy Indian assets would not help the London branch in case of a drain on the London branch. So if it were to develop into an industrial bank its London branch would be a costly luxury. Long-term capital can indeed be tapped by floating debentures and if these are to be floated for 10 to 20 times its present capital the demand for industrial capital would not arise to such an extent as to absorb a part of the industrial capital supply created by the Imperial Bank.

Thus the future business of the Imperial Bank may be extraordinarily wide or restricted. It can carry on banking business, acquire business deposits, make advances, discount bills, issue drafts, deal in exchanges, specie and precious metals. It would be empowered to borrow money and do anything incidental to any of its powers and it would continue the policy of opening new branches as in the past. It may compete more vigorously than at present with the existing banks. If it were to continue holding Government deposits though to a limited extent than at present it will have to maintain a very liquid position and this alone will enable it to maintain the financial prestige which it has built up out of a long and honourable record of service. It is quite fit to conduct exchange banking involving a large turnover

of funds into lock-up advances. But the exigencies of the situation demand its continuance as a true commercial bank, as a bank of deposit, discount and exchange. Its Savings bank department should continue. It can likewise maintain a separate Industrial Credit department where long-term loans can be given to co-operative banks, industries and other banks. Any additional money needed for this business can be secured by floating debentures. This must be definitely understood as non-commercial business and not allowed to directly clash with its commercial business. Thus viewed its future seems to be that of a big commercial bank combining within itself miscellaneous functions of all sorts which would be kept entirely apart from the pure functions of a commercial bank and should on no score be allowed to distract the responsible administration of the Imperial Bank. Enough has been stated to stress the point that it would be dangerous and suicidal to turn the present Imperial Bank of India into an effective industrial bank or a sole exchange bank operating on a competitive basis with the existing exchange banking institutions.

Considering the fact that the most crying need of India is the extension of modern banking facilities into the interior, the Imperial Bank should continue this useful service in the near future. Whether subsidised to the amount recommended by the I. Bank Amendment Act of 1934 or not it should continue to act as a commercial bank and be the acknowledged head of the commercial banking system standing ever ready to tap the Central reservoir of credit by rediscounting agricultural, industrial and commercial short-term paper and passing on these funds to the co-operative societies which would be financing the agricultural industry, the cottage industries and other existing industries so far as *their current* financial requirements might be concerned. The greatest necessity of India is to have a big commercial bank extending sound banking facilities in the mofussil. There is a considerable leeway to make up in this direction of loaning on gold assets and freely discounting the hundis of the indigenous bankers. The good work already accomplished in this field must be pushed forward more vigorously, wholeheartedly and systematically. Appointing the indigenous bankers as its agents and discounting more freely their bills, assisting the co-operative banks in the matter of their cash

credits and overdrafts as before granting advances to agriculturists against produce stored in its godowns or licenced warehouses and lending on precious metals, preferably gold ornaments, it can act as the premier commercial bank of the country. Paras. 142, 144, 181, 182, 185, 252, 391 and 483 of the Majority Report of the C. B. Enquiry Committee amply endorse the above remarks and suggestions of mine.

It is indeed a pity that the C. B. Enquiry Committee as well as some of the recent writers advocate that the Imperial Bank should continue acting as the premier commercial bank, financing liberally the co-operative societies, financing industries on the lines of the "Grossbanken" of Germany and financing of foreign trade on a large scale to secure a breakdown of the monopoly of the exchange banks. Such a position would lead to the placing of too many irons in the fire. Specialisation of functions is the keynote to success in the modern business field. So it should act as the leading commercial banker alone. No undue multiplicity of functions should be placed in the hands of the Imperial Bank. A deliberate disregard of this advice would lead to several difficulties. It is still occupying a special position as the sole agent of the R. Bank and this fact should not be forgotten by the architects who mould the future fortunes of the Imperial Bank of India.

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CHAPTER VII

THE INDIAN JOINT-STOCK BANKS

Early History—Agency Houses—Joint-stock Banks of North West Provinces—The Sepoy Mutiny—Exchange Banks—The beginning of the Joint-stock Banks under Indian management—Its gradual extension—The locale of the Banks—The business of the Indian Joint-stock Banks—Some statistical facts and their interpretation—The Big Four of the Indian Money Market—Bank failures—Bank crisis of 1913-15—Causes—Recent Bank failures—Suggestions.

Early History.

The Indian joint-stock banking is barely a century old. The principles of joint-stock banking were first introduced into this country by the Agency Houses some of which conducted "mixed" banking business. Their primary concern was trade. Of the nature of their business something has been recorded already in my book, "Organised Banking in the Days of John Company." Mr. Thomas Bracken, a partner in the house of Alexander and Company, while giving evidence before the Select Committee of the House of Commons relates the History of the Agency Houses thus:[1] "The Agency Houses were chiefly formed of gentlemen who had been in the Civil and Military services who finding their habits better adapted for commercial pursuits obtained permission to resign their situation and engage in agency and mercantile business. They received the accumulations of their friends in the Company's service. They lent them to others or employed them themselves for purposes of commerce; they were in fact the distributors of capital rather than the possessors of it. They made their profits in the usual course of trade and by difference of interest in lending and borrowing money and by commission. In course of time carrying on successful commerce they became possessors

[1] See the Select Committee o fthe House of Commons, March 24, 1852, p. 151.

of large capital and returned to England. The Agency Houses became the usual depositary of a great portion of the savings and accumulations of the civil and military services in India."

Agency Houses.

Not all the Agency Houses carried on banking business but only a few and the Bank of Hindostan which was formed by Alexander and Co. in 1770 had the right to issue bank notes.[2] But a great many of them performed the three functions of (1) receiving deposits, (2) paying drafts, (3) discounting bills. The real impetus to the starting of banks was given in the year 1813 when an Act was passed removing the restrictions on Europeans settling in India. Several banks were started and during the troublous years 1829-1833 many of the Agency Houses failed. There was 'gross mismanagement, wild speculation and extravagant living' on the part of these big merchant princes managing the Agency Houses. The other reasons for their failure are already related in a separate thesis.[3]

The Union Bank of Calcutta and the Agra and United Service Bank which arose out of the ruins of the Agency Houses met with temporary success but the former bank had to close its doors in 1848. The first Bank of Benares also failed ignominiously owing to fraudulent and criminal mismanagement on the part of its officers.[4]

Joint-stock Banks of the North-West Provinces.

Undaunted by these failures new banks were started in the North-West Provinces. An idea of their operations can be had by a close perusal of Mr. Allen's Minute on Joint Stock Banking in the N. W. Provinces. But the banks of this period could not develop their business satisfactorily. They could not encroach on the foreign exchange business till 1833 as the East India Company considered dealings in foreign exchange as their exclusive monopoly. Though the

[2] See my book "Organised Banking in the Days of John Company," Chapter IV.
[3] *Ibid.*
[4] See C. N. Cooke, "Rise and Progress of Banking in India," p. 236.

Charter of 1833 deprived the East India Company of its trading monopoly and converted this body of merchant princes into territorial magnates, yet the traditional attitude of hostility stood in the way of their growth. Although these banks had their privilege of note-issue also unfettered their issues were small.

The Sepoy Mutiny.

The Great Sepoy Mutiny of 1857 unsettled the country for quite a long time and no bank could arise. But in Bombay, thanks to the Lancashire money which poured in for our raw cotton, banks arose during 1864-66. However they could not withstand the speculative tendencies of the time and fared miserably. Even the Presidency Bank of Bombay fared no better and had to close its doors in 1866.[5]

The Exchange Banks.

At about this period some of the exchange banks were started in London to conduct banking business in India and with the exception of these no Indian joint-stock banks were floated. The Allahabad Bank was opened in 1865. Hardly was quiet restored in this country when the exchange trouble began to cause serious loss. The attention of the people and even that of the Government had to be turned towards this pressing problem. Thus in the 19th century there could hardly be any serious scope for the advance and real development of banking business in India.

The history of the major Indian joint-stock banks for which Indians have been responsible begins from the year 1881 when the Oudh Commercial Bank was founded. The Punjab National Bank was established in 1894. The People's Bank was founded in 1901. The Amritsar Bank was started in 1904. It was in the first decade of this century that a serious impetus was given by the "swadeshi" movement to the starting of the indigenous joint-stock banks. The prosperity of North-Western India increased on account of the opening of the Canal

[5] See my articles "The Early History of the Bank of Bombay,"—based on unpublished manuscript records of the Government. (The Calcutta Review.)

Colonies and the development of export trade in wheat rendered possible the investment of capital in banking companies.

Its gradual extension.

Many large and small banks were established all over the country. But these banks were merely considered as investments by which the people could become rich all of a sudden. But their disillusionment came during the crisis of 1913-15 when almost every one of these mushroom banks was severely put to a test.

Name of the Bank.	Head office.	Date of registration.	Paid-up capital (lakhs of Rupees).	Deposits (lakhs of Rupees).	Branches.
The Bank of India	Bombay	1906	100	1,109	3
The Indian Specie Bank [6] ...	,,	1906	75	270	...
The Indian Bank	Madras	1907	12	99	4
The Bengal National Bank [6] ...	Calcutta	1907	8	81	4
The Punjab and Sind Bank	Amritsar	1908	4	84	...
The Bharat National Bank ...	Delhi	1908	2	7	...
The Bank of Northern India ...	Rawalpindi	1908	1	6	5
The Bank of Baroda	Baroda	1908	30	533	...
The Bombay Merchants' Bank	Bombay	1909	10	2	...
The Credit Bank of India [6]	,,	1909	19	51	...
The Ahmedabad Banking Corporation	Ahmedabad	1910	7	23	...
The Central Bank of India ...	Bombay	1911	168	1,396	...
The Standard Bank [6]	,,	1912	10	...	...
The National Financing and Commission Corporation ...	,,	1912	11	36	1
The Bank of Mysore	Bangalore	1913	20	130	7

All the above banks were started during the " swadeshi " boom days and the stimulus out of the partition of Bengal. Some of these

banks have gone into liquidation but others are still working successfully to the present day.

The locale of these branches.

At present the Indian joint-stock banks are to be found mostly distributed in the Punjab, and United Provinces and Madras and in the Presidency Towns of Calcutta, Bombay and Madras. Rangoon, Karachi, Lahore and Cawnpore have a great number of banks and a clearing house organisation is set up by the Imperial Bank in the seven above mentioned places.[7] There are very few joint-stock banks in several of the provinces such as Bihar, Orissa, Assam, the Central Provinces and most of the Native States with the exception of Mysore and Travancore. But the Banks of Mysore and Baroda are doing creditable services in providing banking facilities for the people of these Native States. Modern banking facilities exist in 400 towns out of a total of 2,500. There are many places which go entirely without modern banking facilities. A recent writer says that the total number of bank offices in 1931 was 906 in all whereas there were 13,000 bank offices in Great Britain and Ireland, over 4,400 in France, 3,100 in Germany and nearly 25,000 in the U. S. A. We have one bank office for every 387,000 head of population in India as against 4,800 in Great Britain, over 3,000 in U.S.A. and nearly 9,500 in Japan. The Reserve Bank's new offices are not included in the above list.

Their business.

Generally speaking these joint-stock banks are commercial banks having two functions before them *i.e.*, (*a*) to develop the money power of the people, (*b*) to provide credit for the various sections of the community. Thus their main business is to attract deposits of all

[7] When the Reserve Bank has 5 centres, some of these will not be covered and this clearing work will have to be performed by the Imperial Bank or the Reserve Bank's Clearing Departmental organisation or the All-India Bankers' Association will have to undertake it.

kinds—current, fixed and savings.[8] They finance trade by advancing monies, opening cash credits and discounting local or inland bills of exchange. These banks prefer to lend on bearer securities which are quoted on the local stock exchanges and in areas where such are not easily available advances are made on piece-goods, other manufactured articles and agricultural produce like grain or cotton stored either in the bank's own godowns or they take possession of the customers' godowns as soon as the advance is made. Almost all the Indian joint-stock banks conduct commercial banking and most of their advances are for a short-term period on liquid and easily realisable securities. Discounting of inland bills is not so prominent and nothing of the nature of acceptance business is undertaken by them. Of late, a few of the bigger Indian Joint Stock Banks are attempting to conduct foreign exchange business also but lacking such special facilities as rediscounting by foreign central banks and the possibility of securing cheap deposit money within this country they cannot hope to compete favourably with the immigrant exchange banks conducting business in our country. Agency, safe custody and internal remittance work form also an important part of their services to the customers. Unlike the American or the English joint-stock banks they do not undertake executor and trustee business on behalf of their customers.[9] Some of the smaller banks lend a small portion of their money on mortgages of properties and advance money to professional people and the agriculturists and landholders.

In the Punjab an attempt was made to finance industries but it proved a failure. Even now some of these Indian joint-stock banks lend on mortgage of properties but such lock-up advances form only a very small part of the total advances. Broadly speaking, they attract

[8] The Central Bank of India has done valuable work in attracting small savings and developing Savings Bank department in conjunction with *home safes*. Other banks would do well to devote considerable attention to this aspect of their business. The institution of three years' certificates for deposits is another commendable feature. Some of the Italian banks pursue this method. It has reconstructed several Indian industrial firms and helped them at the nick of the time. It has opened an Executor and Trustees Company. It has opened the Depositors Benefit Insurance Co. It is helping the Native State of Hyderabad to popularise its currency.

[9] It is only recently that the Bank of India (Bombay) has determined to conduct this kind of business. In 1927 the new articles of the N. Bank of India were drafted and this business was included in the list of its operations.

fixed deposits for which they agree to pay 4 to 5 per cent. for periods above six months and two per cent. for a minimum monthly bank balance say 200 or 300 Rupees. Their rates have been reduced of late during times of economic depression. Though there is no authoritative statement explaining the nature of their business still it can be presumed that they finance the movement of produce from the village to the exporting port and handle the movement of goods from port cities into the interior. Much depends on the environment and the intentions of the founders and the managers of these banks.[10]

Statistical information.

The blue book dealing with banks classifies the Indian joint-stock banks into two classes on the basis of the minimum paid-up capital and reserve of these banks. All banks possessing a paid-up capital and reserve of Rs. 5 lakhs and over are placed in Class A and in B, smaller banks with capital and reserves ranging between Rs. 1,00,000 and Rs. 5,00,000 are placed. Banks belonging to Class II or B are increasing rapidly. The following table shows the steady growth of their numbers and their deposits.

Class A.					Class B.				
Year.	Number of Banks.	Capital Reserve (Lakhs of Rupees).	Deposits (Lakhs of Rupees).	Cash Balance (Lakhs of Rupees).	Year.	Number of Banks.	Capital Reserve (Lakhs of Rupees).	Deposits (Lakhs of Rupees).	Cash Balances (Lakhs of Rupees).
1915	20	438	1,787	399	1915	25	55	91	20
1920	25	1,092	7,115	1,631	1920	33	82	233	42
1923	26	923	4,443	737	1923	43	111	326	61
1925	28	1,060	5,449	1,010	1925	46	118	342	68
1930	30	1,190	6,320	...	1930	54	140	430	...
1934	36	1,267	7,677	1,114	1934	69	149	511	72

[10] A close perusal of the balance-sheet of these several banks will reveal to us that they have been conducting the following lines of business. (1) Keeping current accounts, (2) receiving fixed deposits, (3) discounting inland bills of exchange and hundis, (4) advancing money on securities and Government paper, gold, joint pronotes, goods, fixed deposits, (5) acting as agents, (6) issuing letters of credit, (7) undertaking the purchase and sale of Government stocks and shares on behalf of their customers, (8) realising dividends for their constituents, (9) holding things for safe custody, (10) remitting money drafts, (11) encouraging small savings.

The proportion of the cash reserve of the ordinary joint-stock banks is roughly 15 to 19 per cent. When compared with other countries it is remarkably clear that our banks are maintaining a higher percentage of cash reserve than other countries' banks which keep a cash reserve in addition to balances in the hands of the central bank of issue against their deposits.[11]

	Percentage of cash reserve.
U. S. Member Banks	9·5
The London clearing Banks	11·5
Swiss Private Banks	8·0
Chartered Banks of Canada	11·0
(A group) Indian Joint-stock Banks	19·0

Savings deposits are being attracted on a large scale by the Indian Joint Stock banks.[12] The Imperial Bank itself is attracting substantial amounts under this heading. Savings deposits in the Imperial Bank have grown at a more rapid rate than the deposits in the P. O. Savings Banks itself.[13] But the increase of these deposits without a radical change in the loan and investment policy of the bank is dangerous. Unless some amount of protection by banking legislation is afforded to the holders of these savings deposits attracted by the commercial banks the combination of commercial banking business with savings business opens the way to abuse and it is high time that much thought is given to this important aspect of our

[11] The steady growth of deposits taking place during the course of a decade should be noticed. The proportion of cash held against the deposits must also be considered. Great as is the value of the statistical information for discussion on banking it must be acknowledged that there is not yet a sufficient foundation to permit of a complete analysis of all the problems or to suggest a solution of them. The fundamental importance of banking demands an exact knowledge which can only be gained satisfactorily through a methodical analysis of bank accounts. To achieve this the Statistical Department should be empowered to call in more details of bank accounts for publication in the banking blue-book. A similar act drafted on the lines of the Jalpaiguri Gardens Act of 1912 is necessary to empower the officers to collect bank statistics. See also the remarks of the Bowley —Robertson Committee Report which fully endorse the above view.

[12] Though controlled by a foreign bank it is an Indian joint-stock bank registered in the country.

[13] See W. R. Burgess, "The Reserve Banks and the Money Market," p. 36; as for the item of Indian banks see Banking blue book.

banking situation. It is a pity that the C. B. Enquiry Committee even does not study this aspect of situation.

The Big Four of the Indian Money Market.

Head and shoulders above the rest of the Indian joint-stock banks stand of course the following four banks which can appropriately be termed " the Big Four " of British India: The Allahabad Bank, the Punjab National Bank, the Central Bank of India and the Bank of India.. Their present-day importance can be measured by the fact that their combined deposits in 1925 amounted to an important proportion of the total deposits attracted by the Indian joint-stockbanks.

1925.	Paid-up capital.	Reserve.	Deposits.	Cash balances.
	Rs.	Rs.	Rs.	Rs.
The Allahabad Bank [14]	3,550	5,027	94,516	14,798
The Bank of India	10,000	8,519	1,01,995	24,234
The Central Bank of India	16,813	11,370	1,39,651	30,848
The Punjab National Bank	8,084	2,587	70,492	9,489
Total	38,447	17,503	4,06,654	79,369

If these figures are compared with those of the 28 banks belonging to the first category of the joint-stock banks which possess more than Rs. 5 Lakhs and over (capital and reserve) their strength can be easily detected.

	Paid-up capital.	Reserve.	Deposits.	Cash reserves.
	Rs.	Rs.	Rs.	Rs.
28, banks total	6,73,000	38,694	5,44,936	1,00,955

Thus they own roughly 50 per cent. of the total working capital of these 28 banks and they have attracted nearly 3/4ths of the total deposits and keep roughly 4/5ths of the entire cash reserve kept by these 28 Indian joint-stock banks.[15]

It is indeed a pity that the banking blue book does not give greater details with reference to the assets of the joint-stock banks.

[14] See the Annual Report of the Controller of Currency.

[15] See Statistical Tables relating to Banks in India (12th Issue).

Loans, discounts and investments are not mentioned so that the liquidity or non-liquidity of the assets cannot be easily grasped. Nothing can also be stated as regards the proportional amounts under the different operations. The investment percentages would be of value and in the absence of any details with reference to these any comparison with foreign banking institutions cannot easily be undertaken. As no detailed analysis of the loans has been made it cannot be stated how the lending of credit is done. Unless the proportion of discounts, unsecured overdrafts, advances on goods, advances on book debts and advances on securities to the total advances of the bank are known it cannot be inferred whether they are wise or cautious in the granting of credit.

Bank failures.

In spite of the fact that the existing joint-stock banks have been progressing slowly there have been occasional failures. They are inevitable in an unco-ordinated and decentralised banking system where banks which have committed the mistake of locking up funds in " slow assets " fail to secure any help. The selfish policy of each for itself heightens the gravity of the situation. Such failures are constantly happening even in the organised banking system of the U.S.A. where the State takes direct control and interest in the banking institutions of the country. There is great co ordination existing among the different banks and their clearing houses are active institutions interested in the prosperity and growth of their banks. But bank failures are of daily occurrence.[1] Dr. O. W. Sprague says, " I feel that the problems of these inferior banks are of the utmost importance for the satisfactory functioning of our banking system. The number of bank failures in these sections of the country has been enormously large. All the bank failures were failures of member banks and were of institutions that were heavily indebted to the F. R. Banks. These seem to me to be matters of the utmost importance in the conduct of the F. R. System." While bank failures may be incidental occurrences a long series of bank

[16] Quoted from the Evidence before the Stabilisation Committee by Peel, *ibid*, p. 308.

catastrophies is generally styled "a crisis." A bank crisis may inaugurate "days of panic when there would be general destruction of credit and the most complete interruption of its banking facilities."

Banking Crisis of 1913-1916.

Most of the "swadeshi" banks were viewed with jealousy and disfavour and the older banks refused to lend a helping hand in times of trouble.[17] As Lala Mulkraj says, "The political history of India got repeated in the attitude of these banks towards each other." The Official Committee of Lahore which was appointed to enquire into the causes of bank failures in the Punjab writes that "during the crisis there was no co operation between them and the English Banks or between them and the old-fashioned Indian banks." Lala Harikishen Lal says that "the old banks brought [18] the new ones to trouble and did their best to eliminate the newcomers." Lala Mulkraj says there were formidable forces arrayed against Indian banking in 1912.

"A destructive genius in the person of Rai Bahadur Mulraj arose to destroy all banks—good, bad or indifferent. He employed all forces that could be commended for destruction. Tongue and pen were both used freely and a religious paper was got under control and converted into a weapon for the financial ruin of the country. This fright created mistrust and a run upon Indian banks commenced." The Presidency Bank of Bengal refused to lend even on Government security in spite of the favourable recommendation of its Lahore branch. "Official opinion," was distinctly hostile to the "mushroom banks which were not created in right earnest."

Whatever might be the reason there was a widespread failure of these banks during the years 1913-15.[19] Of all the banking crises

17 See G. F. Shirras, "Memorandum on Banking," p. 6.

18 *Vide* the late Lala Harikishen Lal's presidential address at the Indian Industrial Conference.

19 During the early days of banking in England many of the country banks failed. There were 425 bankruptcies in 1726; 466 in 1227 and 338 in 1728. Several country banks failed during 1811 and 1816. As many as 18 banks failed during a single month in 1825. Till 1844 the business of weeding out incompetent banks continued. In the U. S. A. about 517 national banks failed during the year 1865 to 1911. About 48 National Banks failed during 1921 to 1923. See the Report of the Controller of Currency.

which India experienced that of 1913-15 was the most disastrous one. During the year 1829-32, in 1857 and 1863 to 1866 there were indeed several bank failures and much capital was lost during these times. In the crises of 1913-16 " no less than 31 % of the total paid-up capital of the Indian joint-stock banks was lost. Many of the depositors were ruined. The Indian people have again to be educated in banking business and the banking habit has to be created afresh. This widespread failure gave scope for the statement that " Indians are incapable of managing joint-stock banks. Pandit Madan Mohan Malaviya gave a crushing reply to this malicious charge. Such failures have occurred in all countries and they are indispensable concomitants to the early era of joint-stock banking.[20] Indian banks have failed even though they were managed by European managers. According to Lala Harikishan Lal " there are four dozen banks managed by Europeans which failed in this country during the last hundred years."

A close study of the causes for their failures will reveal the fact that mismanagement due to inexperience in banking affairs accounts for most of the failures. The Official Committee of Lahore says all " the evidence produced before us insisted on the want of business knowledge and inexperience in company promoters, managers and staff as a primary cause of failure. There were few competent managers whether of banks or industrial concerns. Consequently egregious blunders were committed and some of the so-called dishonesty seems to us as due to anxiety to cloak losses." The inexperienced directors were unable to do their work properly. The ignorant shareholders could not satisfactorily exercise their rights and duties.

Most of the directors that were elected to supervise the manager's work and help him with their advice were wrongly chosen and they were easily led away by the opinion of the managers. There was a story current in the Bombay trading circles that the director of one bank did not know English and when the proceedings of the Board were being conducted in English he simply joined the majority on the important questions he had to decide. Such kind of " dummy

[20] *Vide* the Minority Report of the Indian Industrial Commission.

directors" could never influentially dictate the banking policy. Of course, we had no guinea-pig directors but still the first batch of directors of the Indian joint-stock banks knew little of this banking business conducted on the joint-stock principle.[21] These directors were no doubt successful merchants or were men distinguished in one walk of life or other but the mere fact that they have managed one kind of business successfully is no guarantee of their ability to work as directors of a joint-stock bank. Besides there was often times no unanimity in the working of the Board of Directors. The existence of factious spirit marred the proceedings and led to acts of doubtful wisdom.

The managers of the banks were incapable men and had very little knowledge of banking theory. No doubt they were men of some experience but an efficient manager of a joint-stock bank should possess these sterling qualifications to make his bank a successful one.[22] It has been stated that these managers were dishonest and selfish but Balak Ram Pandya, auditor of accounts, Lahore, refutes the charge emphatically.[22] Lala Mulraj, the manager of the Doaba Bank

21 The first acknowledged duty of the bank directors is to see that the funds of the bank are safely employed. They should be men possessing reliable knowledge of accounts business and general working policy of the bank. They should not interfere too much with the administrative routine of the office. They must realise that the Secretary's opinion is entitled to great weight but at the same time they should not be carried away by his wishes. They should have the moral courage to refuse better terms to a director than an ordinary borrower.

22 According to George Rae " the bank manager should possess the following qualifications. There should be total absence of bias—religious, political or social in his mind. He should be quick enough to perceive any change in the circumstances of the customers. There should be no hesitating, dubious and capricious manner. He should be never indolent. Whenever he is in doubt as to the safety of a transaction he should give the bank the benefit of doubt. He should never fly into a passion or bandy words with customers. He should see that all customers are treated respectfully by his officers. In short he should not tolerate any insolence of office at his " bank." Many of our bank managers did not possess these essential qualifications.

23 In his evidence before the Indian Industrial Commission he says, "when we compare the recent bank and industrial failures in the Punjab with similar incidents in other countries we are astonished at the comparatively small proportion of cases in which the failures in our case were due to dishonesty or selfishness. The price we have paid for our inexperience is undoubtedly heavy but it is by no means heavier than what other countries paid before us. If we have learnt the lesson which the disasters of the last few years so impressively teach there is surely no room for despondency."

testifies to the integrity of the staff in the following language: " as for their integrity I may mention that during the ten years' life of the Punjab Co-operative Bank out of a staff of eleven officers only one man was guilty of defalcation of a few hundred rupees.[24]"

The Indian sharholders of the joint-stock banks never performed their duties properly.[25] The shareholders should realise that they are copartners with many others. Their duty " is to put the saddle on the right horse " and see that the officers of the bank are doing responsible duties in right earnest. In no case should they entrust too much power to their manager. They should not place too implicit a confidence in their salaried staff to acquiesce in their doings. Again many of them were not in a position to scrutinise the balance sheets of their bank and climb over " the balance-sheet dodge " as it is styled. They did not choose their men well. The secret of banking success lies in choosing the best men and trusting them completely.

Some other causes undoubtedly hastened and accelerated the downfall of these banks. The difference between " the paid-up capital, subscribed capital and authorised capital " was acting as a handicap from the beginning. As the law did not check this malpractice they took advantage of this fact to trade on the ignorance of the public who were unaware of the difference between the three kinds of capital. To curb this malpractice a heavy stamp duty has been recommended by J. M. Keynes [26] but this would undoubtedly penalise the sound concerns which wish to conduct joint-stock banking. In addition to this every bank should be forced to have a certain amount of minimum paip-up capital, say Rs. 50,000,

[24] See his evidence before the I. I. Commission, the Punjab Volume, p. 290.

[25] George Rae enumerates the following duties of the share-holder : " he should make no line of hostile remark against the bank in times of run. Whenever he hears a bad rumour he should in the first instance convey it to the manager. He should not give currency to any calumny against his bank. He should be the guardian and police of banking credit. His duty is to stand by his bank in times of panic. He should not sell the bank shares at the time of a panic for he would become a bell-wether followed by a score of sheep like himself. His duty is to increase the business of his bank and bring more customers to it"— *Vide* the " Country Banker."

[26] See Keynes, " Indian Currency and Finance," p. 232 : " The stamp duty should be proportional to nominal capital. He instances the case of a comic opera bank registered in Calcutta in 1910 with about Rs. 2,00,00,000 or without having any paid-up capital of its own.

before it commences its business.[27] While the paid-up capital was small the incidence of cost was very high.[28] Liberal salaries, travelling and halting allowances and high commissions to agents and canvassers were paid.

Some of the banks contracted the practice of lending money on their own shares. The failures of the first Benares Bank and that of the Credit Bank of Bombay are attributed to this practice. It is a matter of great satisfaction to see that the Imperial Bank is not allowed to lend money on its own shares, though they may be taken up as an additional security for covering loans. The Charters of the Swiss National Bank of Czechoslovakia, the Reserve Bank of South Africa, the Reserve Bank of India, the Bank of Spain and the Imperial Bank [29] of Japan forbid them from making any loan on the security on their own shares or purchasing the same.

In some cases there was no strict auditing of the accounts. It was a mere farce and " the auditor who was either a creature of the manager or a principal of the fraud was lax in his duties and connived at the bad practices of the managers." [30] The auditor should be a man of much experience in the science of book-keeping and the analysis of accounts. His main duty is to place the facts as they appear to his lights. He should be " the detective of the shareholders who should keep a vigilant eye on the directors always." They can exercise real control over bank policy by frankly discussing the different accounts with the management of the bank and refuse to give a clean certificate if the management is not carefully done. The auditor

27 Such a rule exists in the Canadian banking system. The minimum acquired capital is $500,000 of which all must be subscribed and one-half paid before the Bank commences its business.

28 In the case of many of the Punjab banks the capital was seldom higher than 4 or 5 lakhs. The People's Bank had nearly 80 branches. The result was that the money cost them at 12%. 6% they paid to depositors and their expenses amounted to 6% on the capital." See the evidence of Lala Damodardas, Volume 5, the Indian Industrial Commission, p. 254.

29 See Sir C. H. Kisch, " The Central Banks." See appendix I, Summary of the Charters of these banks.

30 See the evidence of Lala Damodar Das : " The Bank of Peshawar and the Hindostan Bank gave out false balance-sheets and this is rendered possible because the auditors who audited the accounts were not real auditors in the true sense of the word They were merely accountants." *Vide* p. 258.

should see that the directors are not nursing and growing accounts year after year long after they have become doubtful. This is the grim skeleton in the banking cupboard and the auditor should expose it to the shareholders.

Some of the banks indulged in speculative commitments.[31] The Indian Specie Bank's purchase of silver and its attempt to corner silver became a miserable failure and soon led to the closing of its doors. This was one of the factors which brought about its downfall. It had roughly silver worth £3,000,000 on its books when it closed its doors on 1st December, 1913.

Many of the banks were performing quite the opposite of commercial banking business. Instead of making all their assets easily realisable or keeping them in a liquid shape they locked up their funds so that they were no longer " quick assets." What the commercial bank should aim at is " immediate convertibility." All the short-dated deposits can be demanded at any time and it is unwise to invest them in long-dated loans to industrial companies.[32] The Bank managers failed to realise the vast difference between " immediate and ultimate " convertibility. The substitution of the latter for the former means the question of life or death to the bank. They sacrificed the principle of liquidity which should be borne in mind by every banker. Instead of constantly controlling the liquidity of the resources during short intervals by frequent general inventories with the greatest care and instead of keeping a proper composition of security and holdings in their portfolio against their total obligations, they locked up their money in " slow assets." According to Dr. Reisser " the security and maintaining of the liquidity of the assets is a most

[31] The excessive loans made to the cotton-ginning factories were properly speaking speculation." The Hindustan Bank of Lahore granted loans to the Punjab Musical Association Ltd. (a theatre with no capital) and to the Punjab Bros. and Co. (a speculative shop in Karachi). *Vide* the Industrial Commission Report, Vol. V, p. 254.

[32] Both the Punjab National Bank and the Co-operative Bank lent about 10 lakhs to a single gentleman who started a network of ginning cotton factories and presses and put up flour mills. 90 lakhs of rupees out of a crore or so in the People's Bank have been sunk in machinery and buildings and the liquidators would not get even half of that money in less than ten years. *Vide* the evidence of Lala Nandalal Puri, also the evidence of Lala Damodar Das, Volume No. 5, the I. I. Commission Report.

essential task incumbent on the banker. Indeed in view of the variety of claims made on the resources of bankers and of the multitude of aims formed by them it is one of the most difficult problems of banking policy. It is all the more difficult since the establishment of the right proportion of the so-called quick assets to the liabilities, specially obligations falling due at any time or within a certain period, does not always depend solely on the will and discernment of the bank. Possibilities have to be reckoned with for instance that the issue of new shares required to restore the necessary liquidity of the bank's resources after a great increase of business is impossible during bad or critical times; that consequently its assets would be tied up just at the very moment when it might be called upon to realise general embarrassment by proper intervention.[33] Several of the "swadeshi" banks were not in a hopelessly rotten state and this can be proved by two facts. The survival of the Punjab National Bank shows what a capable Indian directorate and staff can do under trying circumstances. Some of the liquidated banks paid the depositors in full.[34] Most of these Indian joint-stock banks paid a very high rate of interest to the depositors. The Bank of Burma undertook to pay 6% on deposits. In order to earn this business out of the banking line had to be conducted and this precipitated its downfall. In the Punjab there was a regular competition to secure deposits. In order to induce several widows and orphans to deposit their money banks agreed to pay 8% under various pretexts.[35] They had to lend at a very high rate of interest and lending at a high rate they could not have good security. Ruinous rivalry produced by competing deposit rates force the banks to entertain illegitimate business.

33 See Dr. R. Reisser, "The Great German Banks," American National Monetary Commission Report.

34 The Marwar Bank and the Punjab Cooperative Bank. The liquidators of the People's Bank were able to give more than 10% dividends to its creditors but the shareholders were not paid anything.

35 If the deposits belonged to minors, widows or orphans or charitable institutions they would give 8%. While the Bank of Bengal rate was on the average about 4% the Punjab banks did not care to regulate their rate for deposits in conformity with the standard rate. On the Bombay side however the deposit rates were governed by the Bank of Bombay rate.

In some cases, notably two or three, banking business included "medical attendance and coach-building." The Hon'ble (now Sir) T. Smith of the Allahabad Bank says, "an institution has no right to be called a bank which undertakes coach-building, ekka repairs, medical attendance, the manufacture of soap and oil and certain things as machinery or engages in trade or manufactures of any sort even though it be stated as follows:—'the leasing, hiring and purchasing of all commodities and substance which can form the subject of purchase and sale.'"[36] The bankers' profession is to take care of the community's floating cash and to turn it to good account, that is to make it productive, partially by placing it at the disposal of others engaged in production.

The Presidency Bank of Bengal did not realise its function of being a residuary trustee and banker's bank. Perhaps as Keynes suggests, "they were not strong enough to support the whole burden." Their apathy towards the struggling Indian joint-stock banks has been vigorously criticised by the Lahore Committee in its evidence before the Indian Industrial Commission.[37]

Some of the Indian joint-stock banks were got up to satisfy some transitory caprice and did not arise to satisfy the legitimate banking and trading requirements of the people. In the city of Bombay some banks arose in this way because the powerful magnates who were not included in the directorate of a bank got up another one under their patronage and were thus the creation of interested parties. It has been suggested that "the jealousy of the exchange banks is responsible for the failure of the Indian Specie Bank." This bank under the able guidance of the late Chunilal Saraiya opened a branch in London with a view to facilitate its business in pearls and

[36] See his evidence before the Indian Industrial Commission (the U P., Volume I, and evidence before the Chamberlain Commission).

[37] Mr W. S. Thatcher complains that this is no valid explanation for bank failures. See his review of Wadia and Joshi. "Money Market in India," Economic Journal, London. But he has failed to understand the character of the 1913 banking crisis. *It was a prosperity crisis* and as in the 1907 banking crisis of the U. S. A. if proper help had been rendered there might had been no failure on the part of the solvent banks at least. It is on account of this reason that Indians feel so keenly the lack of sympathy on the part of the European banks of that time.

silver. The exchange banks resented competition in the exchange business and the rate-cutting that ensued is held responsible for its failure. But as a matter of fact its speculative purchases of silver and the refusal of the Government of India to buy the whole of its silver at its hands precipitated its downfall. The bank also lost heavily in loans advanced to jewellers and the *badla* business of Fazul and David shares.

In some of the Indian joint-stock banks the bank officials took too much of the loanable credit and invested it in their own enterprises. The failures of the Lahore Bank and the Industrial Bank were due to this fault. The Bank of Burma failed in 1911 and out of a total working capital of 1 crore 19 lakhs it advanced 1/3 of it to a firm in which the directors were interested. The locking up of too great a proportion of the bank's funds in one industry is a grave evil and this was not heeded by the European manager of the bank. No bank ought to commit the fatal mistake of ' placing all its eggs in one basket.'' It must never get itself entangled in one or two or three huge and overmastering accounts for the smashing up of such a big customer would spell disaster to the bank. During the course of every-day run of its bills, advances, overdrafts and investments some bad debts may be created here and there but these will not be a matter of serious concern. A bank must be careful in distributing " its risks " as Dr. Reisser puts it.

Excessive interconnection and the interdependence of banking and industrial concerns under a board of common directors as in the case of the Punjab Companies is fraught with harmful results. The Rangpore Bank was started by the Directors of the Rangpore Tobacco Company in order to secure cheap loans and the Rangpore Bank gave loans to this company which was not earning any profit at all.[39] Thus the bank directors stood as both creditor and debtor in the same person. This is only one illustration of the unbusinesslike way in

[38] Of the total advances of Rs. 1,07,00,000-14-1 we find that no less a sum than Rs. 71,72.637-13-1 have been advanced to companies or other concerns in which certain directors of the bank have been interested either as individual directors or as joint borrowers. See the liquidators Report relating to the People's Bank, Appendix VIII, Memorandum on Banking.

[39] See evidence before the I. I. Commission, the volume relating to Bengal.

which loans were granted. It is always an unsound financial principle that lenders and borrowers are to be the same persons.

Some of the Indian joint-stock banks started with enormous nominal capital and they combined high-sounding titles with it so as to mislead people as to the actual strength of their institutions. A recent instance of one bank making "an honourable imitation of the name of another bank" came up for judicial enquiry. Mr. Justice Mulla refused to permit the defendant bank, *i.e.*, the National Bank of[40] Indore, to carry on business under that name.

Most of the Indian joint-stock banks did not maintain adequate cash resources against their demand liabilities. The percentage of cash to the liabilities was only 11% and in some cases it was lower than this. The exchange banks and the Presidency Banks kept a much higher percentage of cash against their liabilities than this 11% (see the statistical tables relating to banks in India, 1930). Frankly speaking these Indian joint-stock banks have not understood the problem of banking business. As one eminent banker says, "If the banks were to keep in cash all the money deposited with them a general failure and collapse would follow after a period of overstimulation. Between these extremities lies the middle course the finding of which is the problem of banking."

In some cases dividends were paid out of the deposits that were coming into the bank for the capital of the bank had disappeared long before this time. The balance-sheets of some of these Indian joint-stock banks were very good instances of window-dressing. Some banks manufactured blooming balance-sheets showing a large amount of assets whereas these banks were really working at a heavy loss. The practice of paying dividends when they were not earned was not given up.[41]

Such and similar instances of mismanagement and lack of proper organisation of the banking business can be quoted but the "two primary causes that led to the collapse of the banks" are (1) the inexperience and the defects of the machinery inevitable to the setting

40 This bank went into liquidation on 1st April, 1925.

41 See the Evidence of Rai Bahadur Lala Damodar Das before the I. I. Commission, Volume 5, para. 225.

up of a new venture. The lack of palliative itself or remedial action such as Government itself or quasi-government agencies, *i.e.*, a state-supported provincial bank might supply."[42]

Again the practice of mutual drawing of accommodation bills between the various banks which they meet with in the foreign money markets would have been of some help to the sound and solvent banks in the hour of their trial.

Recent bank failures.

Though there was a brief respite during the years 1918-20 when the mortality rate of banking companies fell to a low figure still from 1922 there has been an increase in the number of bank failures. The following table indicates the number of failures and the amount of paid-up capital lost on account of these failures :—

Year.	Number of failures.	Total paid-up capital of these banks.
		Rs.
1916	13	4,22,901
1917	9	25,25,914
1918	7	1,46,185
1919	4	4,02,737
1920	3	7,24,217
1921	7	1,25,329
1922	15	3,29,991
1923	20	4,65,47,325
1924	18	11,23,628
1926	14	3,98,145
1928	13	23,11,717
1930	12	40,59,644
1934	30	6,22,553

42 See the Evidence of the Official Committee of Lahore before the I. I. Commission.

The most important of the recent bank failures is the failure of the Alliance Bank of Simla in April, 1923.[43] It was first started in or about 1875. It was an English-managed enterprise from the beginning and most of the depositors were Government civil and military officials. Due to their support the bank had a very successful career from the very beginning and in order to cope with its increasing business more capital was called in and more reserve accumulated out of the profits. The number of branches began to increase steadily. The amalgamation of the bank with other banks as the Punjab Banking Co., the Delhi and London Bank and the Bank of Rangoon contributed much towards further increase of its capital and about 37 branches were established by 1920. It conducted foreign exchange business successfully and was regarded as one of the premier Indian Exchange Banks. To economise its expenditure and its London business the business of Messrs. Boulton Bros. and Company was absorbed. About 1922 the late Sir David Yule had to visit India and reorganise the business on a sound footing but nothing could be done to avert the impending crash brought about chiefly by locking up money in subsidiary companies started by Boulton Brothers. The unregulated state of banking gave free scope to the bankers to pursue the wrong path and the Alliance Bank of Simla had to close its doors in April, 1923. (See the Statistical Tables relating to banks in India for 1923, p. 35.)

It is apparent that the lives of the dead (banks) have not been studied in detail and the lessons of their failures have not been learnt and unless right inferences are properly drawn from the historical survey of the banking crisis this tale of banking disasters would be repeated afresh and Indian banking would have to pass through such disastrous periods till the *law of survival of the fittest* would operate remorselessly and the few but perfect banking institutions alone would remain in the field. The utility of banking legislation at this stage of banking progress opens a wide subject which will have to be dealt with in a detailed manner in a succeeding chapter. The present-day difficulties and their future position are referred to in the next chapter.

[43] The current account and savings bank balances with the bank amounted to 15 crores on 30th June 1922 and by April 1923 they had fallen to 8 crores of rupees and the shares of the bank were quoted at premium on the Calcutta Stock Exchange.

Suggestions for improvement.

Although there is great reluctance on the part of the Indian joint-stock banks to lend against mortgage of real property and factory blocks they ought to lend more on personal security of customers. Both the bigger and smaller banks ought to imitate the practice of granting personal loans to the borrowers on the strength of wages as a basis of personal credit. Mr. C. E. Mitchell of the National City Bank of New York says that by means of personal loans " comprehensive banking service is being rendered to people of all classes.[44] These loans are made at 6%. Increasing number of our banks can make these " personal or character loans."

The bigger Indian joint-stock banks should play a more useful part in the financing of the internal trade of India by undertaking the acceptance function. The charges for inland remittance should be reduced to as low a figure as possible. Instead of financing speculative investors who dabble on the stock exchange they ought to extend their business into the interior of the country and this would not only lead to the " popularising " of banking business but they would tend to standardise the inland instruments of exchange and inculcate better business methods and banking habit in the minds of their customers. A greater use of bills of exchange has to be insisted upon. This would lessen their dependence on Government securities. Much can be done in this direction by the reduction of the stamp duty and the Government consenting to act as drawees in case of all supplies secured by it from local manufacturers. Such bills can be easily discounted by any of the joint stock banks and the Central Bank of the country might use them for currency purposes.[45]

44 See the Monthly Labour Review, Volume XXXI, No. 5, Nov , 1930.

45 This principle of using these bills as reserves for new currency opens up great possibilities of financing useful public works with new money instead of borrowed money. But the Government should be cautious in the retirement of these long-dated bills. The initial cost of the Government would be high for the banks would charge a high discount on these long-dated bills. The Government acceptances represent real values received from suppliers and can be negotiated at the currency office (so long as it is separately maintained and not amalgamated with the Reserve Bank) for new notes for limited periods on fixed terms and this would constitute a cheaper method of finance than the Treasury Bills

It is the duty of the banks to develop trade acceptances in lieu of open accounts and if merchants give preferential terms to purchasers willing to accept such bills instead of opening credits banks in their turn ought to give preferential rates to these merchants in the matter of discounting these bills as compared with those merchants who wish to borrow on overdrafts. The C. Bank would have to give preferential discount and rediscount rates on bank and trade acceptances. This is how trade acceptances are being popularised in the Dominion of South Africa as a result of the recommendations of the Kemmerer-Vissering Committee.

The smaller Indian joint-stock banks which are merely loan agencies must tend to educate the local businessmen to have a banking account, aspire to collect the maximum amount of surplus balances from the community and act as the intermediaries between the C. Bank and the local businessmen. They must make special efforts to entice the small depositors. They can educate the local people by undertaking to buy and sell the Government and stock exchange securities and thus create the investment habit in the minds of the locally rich people. The sale of gold and silver bullion would increase the scope to secure greater profits.[46] A certain amount of push is needed to strike out new avenues for the profitable investment of their capital, always bearing in mind that it is "other's money" that is being lent. It is in this direction that their salvation lies and the reduction of capital on the part of the smaller Indian joint-stock banks as has been done in a few instances is a tacit admission of inability on their part to conduct sound banking business. The Erode Bank of Erode, the Coimbatore Union Bank of Coimbatore, the Bangalore Mercantile Bank of Bangalore and the Mercantile Bank and the Commercial Bank of Vellore have reduced their capital during the years 1924 and 1925.[47] This is not the real solution. Even loans on personal ornaments are advisable for the saving and banking habit can be inculcated thereby.

46 Lending on precious metals (preferably gold) is on the increase. This is indirectly tending towards the spread of the banking habit and they are becoming familiar with the monetary policy of the banks.

47 See the Statistical Tables relating to Banks in India, 12th issue, pp. 14, 15, 16.

There should be courage in developing this class of business outlined above which will not be remunerative at first. The interests of the shareholders would be very important but these must be prepared to undertake certain sacrifice and face loss for some time to come but eventually it would pay them amply. They should not concentrate their attention solely on the declaration of mere dividends but place greater sums into the reserve fund and provident or pension funds and special depreciation funds or branch bank reserve fund. These banks must become instinctively national institutions endowed with the trust of the community. This they can never hope to secure unless they extend the range of the facilities offered. The use of vernacular in the daily routine of the smaller banks can be advocated in spite of initial difficulties. This is the only way of eliminating the domineering foreign element from the banks. A proper geographical distribution of the banks or their branches is needed in the interior of the country under the aegis of the Reserve Bank of the country. An attempt should be made to develop bill discounting. The present-day dependence on Government securities is detrimental to their interest.

The amalgamation of the smaller banks to form major units is the main remedy. If such a policy cannot be ushered in the one of forming "Kommanditen" or a working agreement with the smaller banks and the other indigenous bankers would provide the needed outlet. The creating of efficient banks capable of undertaking the financing of internal and external trade at the same time should be the main endeavour.

The starting of a separate banker's association for creating an *esprit de corps* and thrashing out all the problems of the Indian joint-stock banks is needed. Membership in the All-India Banker's Association is no doubt an essential thing but herein *problems of banking versus other enterprises* will be discussed. Hence the immediate advantage lies in the formation of the Indian Joint-stock Banks Association. The joint stock banks can collect and pool the reliable information collected by them or orthers concerning their clients.

The undertaking of foreign contracts by the banking customers ought to be facilitated by the Indian joint stock banks. This possibility arises when the big commercial banks have foreign branches or foreign connections for the benefit of their customers. The Indian

textile industry can be helped in the Eastern markets by the commercial banks. Commercial transactions have to be initiated by the business departments of the overseas banks of this country. The lack of overseas branches delimits any activity of this kind but the above suggestion indicates the scope for their future expansion. The joint-stock banks can provide cheap and easy remittance facilities to the public.

Some of the existing legal impediments in the way of granting loans on the immovable property of a Hindu or Mohamedan family should be removed. Section 58 (*f*) of the Transfer of Property Act should be made applicable to important business centres so that equitable mortgages might be the basis of further loans to customers. To facilitate the use of credit instruments *bearer* instruments should always be considered *bearer* instruments despite subsequent *order* endorsements.

Above all an economic working of the different branches is needed so that a top-heavy administration as in the case of the Imperial Bank or some of the foreign banks does not arise.

Better and more sympathetic relations with the existing industries have also to be evolved.

More efficient joint-stock banks working under the fostering guidance of the R. Bank can secure marked *qualitative* and *quantitative* improvement in the field of our credit organisation. An excessive holding of Government securities has unfortunately tended, in the absence of open market operations of the R. Bank, to cause them grave anxiety.

The formation of a bank *cartel* on lines which exist in France would have to be encouraged so that the payment of high deposit rate of interest can be eliminated. The individual lowering of interest rates and current accounts to 1% and 1/2% in the busy and slack seasons is to be deprecated. A conjoint action through the Clearing Bankers' Association can be undertaken to have a uniform nation-wide lowering of interest rates on fixed deposits. Payment of interest on current accounts has to be abolished altogether. The 13 Exchange Banks combined together to issue such a notice regarding the lowering of interest rates.

Realising full well that the progress of certain joint-stock banks was solely due to the helpful attitude of the Native States it can be easily recommended that a similar and definite policy of encouraging joint-stock banks ought to be initiated. The grant of free transfer of

funds from one branch of the R. Bank to another, same remittance facilities as in the case of the co-operative banks, special rediscount facilities at the hands of the R. Bank and other helpful measures as the institution of country-wide clearing facilities would encourage the existing joint-stock banks.

Following the policy of the business departments of the big American banks the Indian joint-stock banks ought to find new connections not only by advertising, by the issuing of periodicals, publications, calendars and so forth but by canvassing among businessmen of importance.

CHAPTER VIII

The Future Outlook of the Indian Joint-stock Banks

Introduction--The banking pathologist—Poor qualitative progress—Causes for the structure—Over-investment in securities-competition—P. O. Cash Certificates—Exchange banks—Hard times and depressed trade—Failures—Remedial measures—internal and external—Administrative measures—Legislative measures—Co-operative efforts—The C. B. of Issue—Conclusion.

Introduction.

The future can be built on the present which is but the result of the past. Considering the present position of the Indian joint-stock banks we find them declaring lower dividends than in the immediate past or fairly even rates of dividends than in the past. Lack of confidence on the part of the public, sheer inability to secure any prompt financial aid and overinvestment in gilt-edged securities due to lack of a fluid market for short-term investments, are some of the salient features of the present-day Indian joint-stock banks.

The banking pathologist.

The pathological point of view has strong fascination for me. As in Matthew Arnold's famous lines I have an ardent desire to play the role of banking pathologist.

He took the suffering human race,
He read each wound, each weakness, clear
And struck his finger on the place
And said 'Thou ailest here and there.'

But the inadequacy of statistical material precludes anyone from playing the part of a banking pathologist. Its being scattered or diffused in more places than one irritates the worker in the field. The Statistical Tables relating to the banks, the Report of the Registrar of the Joint Stock Companies, the Report of the working of the co-operative movement, the Indian Trade Journal and the weekly

information issued by the Controller of Currency would have to be ransacked for what little can be gleaned from these enigmatic reports.

The Imperial Bank always follows the policy of " never explain, never regret, and never apologise." No annual report portraying the financial state of the country is issued. There is no Banker's Journal displaying the combined figures of their working. In the absence of such information one has to literally grope in the dark to feel one's way in the matter of our banking operations and their significance on the different aspects of our economic life. The method of analysis cannot therefore be applied for details of bank organisation, methods and practices are shrouded in mystery.

In spite of the nominally increasing growth of the working capital of the Indian joint-stock banks as denoted by the *Statistical Tables relating to Banks in India* their present position is really deplorable. Compared with the contemporary foreign banking institutions their record is indeed a depressing one. As adequate banking statistics which cover the entire field are conspicuous by their absence I refrain from making any appeal to any statistical device to show how our system is progressing when compared with others. The stationary and sometimes declining dividends speak eloquently of the struggles of the Indian joint-stock banks. Their low cash reserve as against their demand obligations fails to inspire the necessary confidence in the minds of the depositors. Unorganised, unaided and subject to the malicious propaganda or barbed darts and credit wrecking tactics of their enemies the Indian joint-stock banks are " muddling through somehow." If timely action is not taken the unfailing and inexorable law of the survival of the fittest would soon eliminate quite a large number of these tottering institutions.

Present position.

With no banking legislation, no official supervision, no fluid market for short-time investments which consequently leads to an over-investment in gilt-edged securities, no co-ordinated policy of the different joint-stock banks, no centralised banking in the way of the rate of interest, no check against the frequent happening of swindles by direc-

tors or officers of banks and no national policy on the part of the State the Indian joint-stock banks have been unable to show any remarkable progress. Though some of the Indian joint-stock banks are not incapable of holding large monetary resources yet the logical consequences of the above circumstances are bank failures now and then. Now that the reorganisation and radical reform of banking are under contemplation the broad lines of reform may be indicated briefly. A unified banking system with an independent Central Bank of Issue acting as a regulatory authority in a carefully developed discount market and creating elastic currency to satisfy the needs of business must be the sole object of banking reform. A complete rationalisation of our banking system is needed at the present hour. It alone would tend to promote specialisation in credit business and without an efficient use of credit, agriculture, commerce and industry cannot be established with any degree of success. It is to the banker, the chemist, the physicist and the engineer that India has to look to recreate her economic conditions and lead to a fuller utilisation of her small dormant hoards of precious metals and a better working out of the industrial opportunities, thereby increasing the total wealth of the country and the prosperity of the people.

Poor qualitative progress.

Lacking the fostering guidance of a true Central Bank of Issue or an encouraging policy on the part of the Government the Indian joint-stock banks have been functioning in a credit organisation whose growth can be aptly compared to that of a wild jungle. The lack of positive information and detailed statistical knowledge precludes one from making any judgment as regards the safety and solidity of our joint-stock banks. Although it is an accepted fact that the dividends of some of the established banks are fairly higher than the return from trading or other joint-stock companies, still the fact that more capital is not being invested in the expansion of the existing banks or the establishment of new big joint-stock banks speaks for itself. The qualitative aspect of Indian joint-stock banking is far from convincing and the quantitative aspect is equally disappointing.

Causes.

What are the causes leading to this unfortunate position ? Some of the causes stated by the managers of the joint-stock banks are analysed and a critical scrutiny and analysis of their statement leads to certain important conclusions as regards the planning of their immediate future.

Over-investment.

Like the Imperial Bank the majority of the Indian joint-stock banks hold large blocks of Government securities.[1] Even these cannot be turned into ready cash. There were no open market operations on the part of the Imperial Bank to steady their price or defeat the bearish factors and tactics of the operators on the stock market. Without reasonably stable or steady value attached to the Government securities the banks would find it difficult to maintain steady dividends. Again the recent fall in the interest on Government securities is a timely warning that they should desist from this policy.

Secondly, as the deposit rate they pay is high the interest secured from their investments does not generally give a broad margin over the deposit rate which they agree to pay. Broadly speaking, banking profits depend on the difference at which they lend over the rate which they pay for their borrowing from the public. Thirdly, the Indian joint-stock banks are therefore forgetting their social mission which is to aid commerce and industry.

It is indeed true that the holding of Government securities or trustee securities, ought generally speaking to be considered a healthy sign indicating the true financial strength of the joint-stock banks. But unfortunately owing to the above set of circumstances described already the investment policy has been causing them grave anxiety. Again no commercial bank ought to congratulate itself on its possessing a higher amount of investments over and above its actual paid-up capital. It is bound to create grave trouble whenever it wishes to expand its business or open branches in the interior. Although full

[1] The C. B. Enquiry Committee endorses this opinion and says " a large proportion of resources is locked up in gilt-edged securities as compared with bills."

regard to liquidity has to be paid still this over-investment even in gilt-edged securities has to be given up. The English banks persistently sold their surplus percentage of war-time investments immediately after the war. From £398·6 millions in 1919 they came down to a low level of £290·5 millions in 1927. The sum realised was utilised as advances to commercial borrowers.[2] Such a policy of pronounced reduction in the matter of their investments would undoubtedly improve the situation. Even the Presidency Bank of Bombay suffered in a like manner on account of its excessive holding of the East India Company's paper. Finally it proposed to open a branch in Calcutta in 1841.[3] As this was not allowed it suggested the undertaking of foreign exchange business so as to find work for its huge capital. Considering the possibility of the Hon'ble the Court of Directors refusing these measures it suggested the alternative of reducing its capital exactly to one-half and that the note-issue should similarly be cut down to one crore of rupees alone.[4] The Court of Directors refused to permit any of these measures and until there was the cotton boom in 1860 there was not properly speaking any legitimate trade demand absorbing its huge paid-up capital which had to be locked up in the Company's paper alone which paid four to five per cent. rate of interest.[5]

Competition.

Taking leave of the discussion of excessive investment we must turn to the second reason which is repeated by the managers of the Indian joint-stock banks. Since the late Mr. A. Bowie raised the cry of "uneconomic competition" *on the part of the Imperial Bank of India,* the Government of India and the existing Provincial Co-operative banks and District Central Co-operative banks and the Exchange Banks are looked upon as rivals tending to spirit away deposits which would

[2] See J. Sykes, "The Present Position of the English Joint-stock Banks," p. 68.

[3] See my book "Organised Banking in the Days of John Company." pp. 487-494.

[4] See the Report of the Directors of the Bank of Bombay submitted on 2nd September, 1852. These requests were not sanctioned by the Hon ble the Court of Directors. See their Financial Letter to the Government of Bombay; Letter No. 1 of 1853, dated 19th January, 1853; Paras. 3 and 4 of this letter explain the reasons for their refusing to sanction this request.

[5] See the Resolution No. 19, Financial Letter from the Court of Directors to the Bombay Government, dated 20th July, 1843.

naturally have flowed into their hands in the absence of any of these competing rivals.[6]

Much reliance cannot be placed on the supposed cut-throat or uneconomic competition on the part of the Imperial Bank of India. It is the acknowledged policy of the Imperial Bank to consolidate its present position at the existing two hundred branches and not to open more branches in the meanwhile. Competition with the indigenous joint-stock banks is always deprecated so long as the latter are charging moderate rates of interest. It is the declared policy of the Imperial Bank to open a branch only where scope exists for two banks. Even though a branch of joint-stock bank might exist the Imperial Bank would open a branch so as to extend banking facilities to the people of the locality. So long as the dangers underlying branch banking are understood and every effort is made to eliminate them this system of extending branches by the Imperial Bank has to be hailed as a welcome measure. None the less there is a grain of truth lying hidden in these blasphemous remarks of the joint-stock banks. Unable to secure interest-free Government deposits they have raised the cry of state-subsidised or aided competition. The State however has to select a strong bank as its depositary for the Independent Treasury System has grave evils of its own. The system of nursing weak banks by declaring them as Government depositary banks is no less an evil than the one of maintaining an Independent Treasury System of its own.

Although there might be some amount of truth in the above contention still the grievance that the co-operative banks are effective competitors as they tend to attract deposits by offering high interest rates is entirely a mistaken notion. As in modern Germany or France we do not find even our urban or the provincial co-operative apex banks conducting business on similar lines which the commercial banks adopt.[7] In Germany the co-operative banks grant on the well-

[6] See Resolution No. 19, Financial Letter from the Court of Directors to the Bombay Government, dated 26th July, 1843.

[7] Even though the Imperial Bank's branch has been closed at Serajgunj and the local Central Co-operative Bank has been attempting to fill the void, the question of opening current accounts collecting cheques and bills is not taken up and sanction has to be obtained for this from the Registrar of the Co-operative Societies for these purposes. See the Free Press Message, the Liberty of 12th September, 1929. In some places however the co-operative banks are opening current accounts, purchasing drafts and selling remittances.

known basis of the cash credit system and discount bills. Even in modern France the situation is the same. The co-operative banks created by the state initiative and financed to the extent of 50 million francs are acting as the ordinary joint-stock banks for the locality. Such competition hardly exists in any of the money centres of this country. It is true that the co-operative banks offer a high deposit rate. As I have stated elsewhere they are "complementary institutions." Their sole aim is to play the humble role of "collecting banks." They are feeders to the joint-stock banks for it is their mission to endow such people with moderate capital and train them to banking habits and prepare them for business with more capitalist institutions to which they are likely to go as they become wealthy. Such being the case there is no reason to take umbrage on account of their successful working. In the near future when trade financing is done by means of bills the trade papers endorsed by the co-operative banks would furnish ample opportunity for the safe investment of their funds. Greater co-operation would thereby ensue between the Indian joint-stock banks and the other kinds of banking institutions or bankers. Co-ordinated and not competitive banking must be the ideal that ought to govern their operations in the future.

P. O. Cash Certificates.

The Government of India which has already incurred their displeasure for depositing its funds in the Reserve Bank and the Imperial Bank alone, has once again become a target of criticism. By virtue of increased interest rates which it has agreed to pay to the holders of the P. O. Cash Certificates from the 1st of August, 1929, it is feared that it would tend to divert the flow of deposits from the usual channels to the hands of the Government of India. That the Government of India would absorb the available savings is the specific grievance which has been set up by them. Since these lines have been written these high interest rates have been cut down to lower figures.

Even the exchange banks consider this effective competition on the part of the Government as one of the reasons for the slow growth of their deposits. The floating of Treasury Bills and the currency contraction in the slack season though ostensibly pursued with the object of propping up exchange is disliked by the Indian joint-stock

banks. The treasury bills are being floated at "rates of interest which no bank even of modest means could think of giving its depositors." [8] This has been acting as a double-edged weapon. Firstly, it has tended to restrict the volume of their deposits. Secondly, it has tended to demoralise the tone of the stock market and the Government securities have naturally suffered depreciation as a result of unexpected shifts in the matter of Treasury bill sale policy.[9] But both these counts of indictment have been silenced already. The P. O. Cash Certificate rate has been reduced and the Treasury bills are being floated at low rates. (*Vide* the Report of the Controller of Currency, 1934-35.)

Exchange Banks.

Repeated failures of the Indian joint-stock banks have turned the people more to the exchange banks who have already become unpopular for their exclusive monopoly of financing of foreign trade. Their deposits are increasing though they pay no high rate of interest. Being the victims of unorganised banking the Indian people naturally prefer to place trust in the foreign exchange banks whose directors at least are to a certain extent free from the taint of swindling bank resources and utilising them for selfish advantages of their own. The Exchange Banks have built up a tradition of trustworthy service. They usually have at their service a continuous succession of honourable and loyal men. They are gathering vitality as they go—becoming not weaker with age but stronger and more trustworthy in marked contrast with the few traitors of our Indian bank management who have undermined the prestige of the other contemporary Indian joint-stock banks and have contributed a good deal towards their stagnation and decay. The main excellences of the exchange banks namely, skill,

[8] If we study the English banking system the average rate at which T. Bills were floated was £4-10-3 hardly higher than the rate at which the commercialists were able to secure the discounting of bills by the banks which was £4-9-6. This shows that the British Government in spite of its increased indebtedness did not pay very high rates for its short-term indebtedness. See Sykes, p. 91.

[9] It is a matter of gratification to find that this opinion is fully endorsed by the C. B. Enquiry Committee on p. 405. " The Treasury Bills have not yet become an integral part of the money market *at their proper value.*" After the starting of the R. Bank the position has changed.

trusteeship and scientific method must be copied by the Indian joint-stock banks. The general faithfulness of the Indian joint-stock banks is not questioned by anybody but they must copy the best features of the exchange banks. It is banking education that can create these features. It is not the men in high places of power alone but also those who are stationed in every rank and level of banking service who must realise their responsibility and be willing to do their best.

Depression and hard times.

The prosperity of banks is purely a relative phenomenon mainly depending on the prosperity of its customers who are suffering from a fall in the price of land which they bought at fabulous prices in the boom days of 1921 or if dullness of trade were to prevail as in the days of post-war depression, it is bound to tell adversely on the banks also. There is indeed a lot of truth in the above remark. It is only in 1927-28 that Indian trade and commerce reached their pre-war level. Trade and commerce are feeders to banking. Without banking facilities they themselves cannot be fed properly. They are as much dependent on the banks as banks are on the traders and merchants.

Failures.

Lastly the incessant and never-ending failures of the Indian joint-stock banks [10] often remind the people of the fact that it is altogether sheer folly to place confidence in such mismanaged institutions as the joint-stock banks generally prove to be as soon as their management changes

10 See the "Statistical Tables relating to Banks in India."

Year.	Number of banks involved.	Paid-up capital. Rs.
1918	7	1,46,185
1919	4	4,02,737
1920	3	7,24,717
1921	7	1,25,329
1922	15	3,29 991
1923	20	4,65,47,325
1924	18	11,33,623
1925	17	18,75,795
1926	14	3,98,145

hands from the original set of people. Without the continuity of experienced management deposits in a bank cannot be considered safe. Repeated failures are[11] shaking the credit fabric of the joint-stock banks. It must be borne in mind that a "system of banks is like a crowded city where a fire breaking out in one house may soon spread to many others and every house has to bear not only its own fire risk but some risk of all the rest." Without a far higher standard of banking prevailing among the Indian joint-stock banks it is impossible to consider the banking structure as a sound and strong one. The present-day joint-stock banks are not regarded as national institutions endowed with the trust of the community.

Planning of their future.

A harmonious atmosphere congenial to their rapid development has to be created. The definite programme of banking reform falls broadly under two headings, *viz.*, internal and external. The internal reorganisation has to be brought about by the Indian joint-stock banks. This is more important than the external agency or aid, for without the former the external agency would either decline to lend aid or even if it were to be rendered no lasting and permanent improvement can be achieved in the position of the Indian joint-stock banks. An external agency can mend the evils but what is required is a radical cure which can arise out of a proper internal reorganisation and the carrying out of suggestions outlined in the previous chapter.

Of the external remedies, the administrative measures of the Government, further legislation and a more enlightened public debt policy deserve proper attention. The co-operation on the part of the depositing public and the borrowing customers and close co-operation amongst the bankers themselves would go a long way in improving the situation. But the creation of a Central Bank of Issue is the proper remedy for many of their present-day defects.

11 Quite recently the Karachi Bank failed and a desultory acquaintance with the history of Indian Banking would show how the lack of confidence created by bank failures has been a well-marked feature since the second half of the 19th century.

The internal remedy.

Taking the internal remedy first into consideration the Indian joint-stock banks would have to sacrifice or give up the unnecessarily large holding of Government securities.[12] In their endeavour to incline towards safety they are leaning too much on this support. Sound commercial advances marshalled in a steady succession of maturities are more lucrative than gilt-edged securities. Banks must invest wisely and not speculatively. True wisdom in the matter of bank investment consists in avoiding "frozen assets." The problem of finding adequate business for the released funds would have to be faced. Indirect financing of agricultural interests through approved indigenous bankers or traders purely on the personal knowledge of the indigenous bankers can provide the needed avenues. Unless they care to cultivate more regular business dealings with the indigenous bankers the mere financing of trade and industry in the big centres would not absorb all their liquid resources. The banking net must be spread wider so as to cover a greater area than at present. It is the financial life of the big cities alone that they are able to influence at present. They must descend to rural tracts and hope to influence the lives of

[12] Broadly speaking, the banking policy in the matter of investments is to select liquid and easily realisable securities possessing steady value and a wide market. As gilt-edged securities possess these features the bulk of bank investments consists of Government securities. But these do not form the only item in the matter of investments. If the bank conducts issuing business the shares of new companies floated by it are generally held by it till the time the investing public digest these shares. Similarly a city bank seeking to extend its operations in the most safe and economical manner tends to acquire shares in the banking companies of the interior and hopes to influence their policy and seeks an outlet for its surplus funds. The shares of a foreign banking company might be required so as to affiliate it to itself. This might not be done with the express purpose of conducting foreign banking on any large scale but merely to render more efficient service to its own customers in the direction of financing foreign trade Indian banks do not generally possess such a wide range of securities and shares. Shares of a few industrial companies form the major constituents of the investment items of the Indian joint-stock banks. The acquisition of interest in other banks, domestic or foreign, is not yet a marked feature of the policy of any one of the important Indian joint-stock banks. The daring yet fruitful policy of the Lloyd's Bank or the Barclay's Bank in this direction finds no counterpart in the Indian joint-stock banking system. Too large a holding of gilt-edged investments is carried out of the investible surplus. This has to be rectified. Since these lines have been written the Central Bank of India has opened a London branch or bank to conduct Indian exchange banking on a large scale.

the masses in a significant manner. The real problem of Indian banking is to secure to the Indian joint-stock hanks power so as to enable them to control the indigenous bankers and they should themselves be controlled by the Central Bank of Issue. This is the unity that ought to pervade our banking structure. The present-day loose and unorganised system has to be displaced by a more co-ordinated and highly integrated banking system.

Secondly, as one reputed Professor of Economics stated "a banker ought to be two-fifths gentleman, one-fifth economist, one-fifth lawyer and one-fifth accountant." Unfortunately the lack of such high qualities renders possible mismanagement of banks. A weak, loose, and inefficient audit unable to influence the bankers usually tolerates such inconsistencies, till the day of final reckoning comes when some important incident leads the depositors or lenders of money to doubt the standing of the bank and the attempt on their part to collect the deposits brings to an end the existence of the tottering bank.

An expeditious and efficient service and the expanding of general agency business alone by them is sure to bring in greater deposits and more constituents. Banks have to go to the people and not wait for the people to come to them. If there is sufficient employment for these funds the financial strength of the Indian joint-stock banks is sure to increase. No time should be lost in attempting to reform and reorganise the internal framework on a sound basis. It is not for the sake of mere self-interest that this reorganisation has to be undertaken by the volition and prescience of bankers themselves. Unless this is carried out immediately the mere setting up of any external agencies would not solve the riddle and even these external agencies would consider these Indian joint-stock banks a constant source of anxiety. The help that any external agency would render can bear fruit only under improved management of the Indian joint-stock banks. It is foul financial weather that is the real test of sound banking and I venture to think that without real improvement in the internal management of the banks their position would become strained if another crisis of the nature of 19,3-15 period were to happen.

External remedies.

A more enlightened policy on the part of the Government with reference to Rupee loans and the Treasury bills is needed and everything

depends on this important reform It is absolutely imperative that no further suspicion should be raised that the Government is bent on floating further Rupee loans in the Indian money market. The slackened response to the last Rupee loan means after all that it is high time to consider the advisability of proceeding slowly in the matter of capital expenditure on the part of the Government even for productive undertakings. The present market value of gilt edged securities should not be tossed about hither and thither as a result of the vacillating public loan policy. Further depreciation of the value of Government securities means further cuts in the profits of the Indian joint-stock banks and the dividends they declare. Lower dividends mean lower deposits. The lower the working capital the lower would be the profits unless it is offset by greater turnover of the capital resources. This is the vicious circle that is being induced by the present-day public loan policy. Since the starting of the R. Bank conditions have greatly improved and a timely loan floatation is forthcoming.

Administrative measures.

Several critics have pointed out the necessity of pursuing a strictly scientific policy in the sale of the T. Bills. The resort to the T. Bills as a deflationary measure in order to support the sterling value of the rupee in the slack season is undoubtedly tending to the reduction of deposits available to the banks. Firm money conditions induced by their sale may succeed in bringing about an improvement in the rate of exchange and maintain it at a safe level. The high rates paid for them as well as the long-term loans would mean in the long run greater inroads on the taxpayers' purse.[13] This unnecessary increase of tax burden when the taxable capacity is so very low has to be borne in mind. It would have an adverse effect on the purchasing

[13] It is not germane to this topic to discuss the economic effects of public debts. The floating debt even though it might consist of treasury bills has its effect on the bankers. Apart from financial danger to the state the inconvenience to trade and commerce is no less grave. The possibility of habitual renewals tends to make it permanent. This acts as a detriment to banks for their deposits would be cut down and the discount rate would rise. Prices of goods rise and the standard of living tends to become very high. The banks might hold these safe Government promises and refuse to take risks involved in commercial loans.

power of the people and trade would not recover rapidly as a result of this deflationary policy which of course is due to their anxiety to keep the exchange rate above 1*s*. 5 49/64*d*., the gold export point from this country. So long as the sterling resources are few there can be no sale of gold at this export point. The Reserve Bank would always be anxious not to allow exchanges to fall below the gold export point from the country. Its bounden duty is to maintain stability of value for the rupee in the external trade relations at the same time.

Legislative measure.

Another direction by means of which the Government can hope to protect the depositors as well as the public lies in passing helpful and suggestive legislation Government guarantee of deposits and the formation of a ' safety fund ' are bound to be mere palliatives and do positive harm to the co-operative banks. The possibility of few depositors being selected as bank directors is a remedy which can only be permitted by a change in the existing legislation with reference to the joint-stock banking companies. Those taxes which are interfering with the development of the banking amalgamation movement have to be removed. A readjustment of the taxes on a lower level than at present would act as a further impetus in the starting of more banks and in view of the fact that the indigenous bankers are to develop into modern banks this recommendation has to be virtually carried out. The possibility of selecting a few other banks " as public depositaries " [14] after exacting due security would

and discounts. It is liable to provoke inflation. Lastly, it might lead to grave consequences if renewals of T. Bills are slackened. Foreign holders of these lose confidence in these certificates and national money and this loss of confidence affects adversely the national rate of exchange. For a more complete discussion see the Revue de Science et de Legislation Financieres," January to March number 1925, pp. 100-102.

See also H. E. Fisk, " French Pubilc Finance in the German War and To-day," pp. 15-17.

See also H. C. Adams, " Science of Finance," p. 526.

14 See the U. S. A. where there are a large number of banks 7,224 acting as public depositaries. See the Annual Report of the Treasurer, 1926, p. 604, " One bank in every four is a Government depositary."

have its own efficacy at the present juncture when even the old established Indian joint-stock banks are not able to create the needed confidence It is indeed true that the false tongue of rumour cannot be controlled in any effective manner Its vivid conjectures can be silenced only by publication of relevant facts indicating the general financial strength of the banks. The financial intelligence of the reading public can after all be a more effective safeguard than any legislative enactment.

A separate banking code which safeguards their interests and procures a healthy development of banking expansion is needed

Co-operative efforts.

The depositing public and the shareholders would have to co-operate with the bank management in every way. If the depositors are taken into confidence by the managing board there is no reason why they ought to get shy of the Indian joint-stock banks Advisory Committees of depositors and influential traders to help the branch managers in the matter of investment of banks' funds would be very helpful.

Sometimes the frauds and malpractices which the banks have experienced from time to time have led to stricter regulation and restriction of credit by the banks with the result that *bona fide* constituents have suffered as a result of this vigilant attitude. This attitude should not be mistaken by the *bona fide* constituents. Qualitative banking would be promoted thereby.

The Reserve Bank.

The Reserve Bank would indeed improve the situation of the joint-stock banks in several ways. Besides providing rediscounting facilities and thereby enabling them to convert their assets easily into liquid cash a Central Bank is bound to confer inestimable advantages on them in the following directions. A careful scrutiny by the Central Bank which would be made at the time of rediscounting the eligible commercial paper would automatically raise the standard of banking. The very example of its conservative management would act as an elixir or life-giving tonic to the almost stagnant Indian joint-

stock banks of the present day. If the constituent [15] position of the Central Bank is so devised that it precludes competition with the commercial banks this by itself would afford an impetus to the joint-stock banks to extend into the interior in their endeavour to secure fresh business. But the Imperial Bank can also grant advances (so long as the Reserve Bank is not started) at 1% below bank rate on the security of gilt-edged stocks or investments so long as they fail to convert them into liquid resources. It is not by merely lowering the bank rate that the lending policy can be liberalised or made elastic. Less harsh restrictions than are prevailing at present would mean helpful overdrafts to the Indian joint-stock banks and a part of the interest-free national balances secured by the Imperial Bank can be utilised in this manner. Timely help and succour by means of liberalised discount policy should be adopted instead of a mere spoon-feeding one such as the facilitating of internal transfer of funds or remittances at low rates. The policy of starting of more clearing houses which the Imperial Bank has already done has to be continued further. The Indian joint-stock banks as well as the Imperial Bank ought to be aware of current developments and current thought and move with the progressive times.[16] Co-operative banks are tending to become commercial banks in some important centres where jt. st. banks are not existing at present. Such facilities which are granted to the co-operative banks should also be granted to the jt. st. banks.

Conclusion.

A clear and consistent action on the part of all the interests concerned is necessary and the co-operation of the different sections would secure to the Indian joint-stock banks a solid ground for their

15 This can be done by confining its business to note-issuing and discounting trade bills of short currency and it would be prohibited from doing ordinary banking business of a commercial bank.

16 Even the English joint stock banks which are considered as 'paragons of conservatism, have changed their policy towards industries. Even in America the banks have followed a liberal lending policy Extended loans and less rigorous insistence in the matter of repayment are evidently a proof of their sincerity that they do not hold a too-detatched view towards industries as in the past. This elasticity in the matter of lending has to be noticed. See H. W. Macrosty, "Trade and the Gold Standard,"—paper read at the Royal Statistical Society of London, December 18 1926. Quoted from the London "Economist" (December 25, 1926), p. 117.

further expansion and economic development of the country. Small Indian joint-stock banks or loan companies are being started here and there. If the monthly reports of the Registrar of the Joint-stock Companies are examined the activity of the people in this direction can be immediately realised. But *in the economic sphere it is not mere quantity but quality* that tells. Few sound banks can achieve more permanent outstanding benefit for the country than many bogus banks which tend to put back the clock of economic progress. National well-being, price-levels, profits, employment and purchasing power of wages are of essential importance. Their control by a sound banking policy under the capable leadership of a nationally managed Central Bank would secure the economic welfare of the millions of this country.

To sum up this survey reveals much that is defective in the present-day situation of the Indian joint-stock banks. To increase their usefulness, self-improvement, external aid and thorough reorganisation of the entire banking structure are pointed out as the proper remedies which can guard them against further deterioration. All parties should co-operate in this endeavour as it is a problem of national importance. The present joint-stock banking system must be made safe, economical, adequate and efficient at the same time so as to afford maximum utility to all sections of the community. Incidently it can be remarked that the present-day absence of definite trustworthy information of banking operations and statistics has to be remedied as early as possible and such figures as furnish real information or artfully unfold the tale of banking progress should be published by the different units of the banking system.

Conditions are now becoming favourable to the expansion of commercial banking, *viz.*, an increase in the available capital and deposits, expanding requirements of trade and commerce and increasing number of capable and honest people to do banking business on sound lines. The Indian jt. st. banks have to make every effort to increase their utility and secure better economic progress of the country.

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CHAPTER IX

The Loan Companies of Bengal

The Loan Companies of Bengal—The Small banks of South India—Working capital—Unfettered competition—Rationalise the banking industry—Specimen of a loan company or small bank—Operations in Bengal—The defects of these loan companies and small banks—Proposed lines of action—The example of the United Kingdom—Its results—Impossibility of amalgamation with bigger banks—The main advantages of the amalgamation movement—Other expected advantages—Can the proposed Federal Bank stem the tide—Why not depositors as directors—The Bengal Bankers' Federation—The aim of the Federation, general long-period effects—Difficulties in the path of the amalgamation movement—Conclusion.

The Loan Companies of Bengal.

The blue book on the joint-stock companies records the existence of 572 loan companies and 473 banking companies in Bengal. Several more might be existing in the province of Bengal. Their total paid-up capital comes up to several lakhs of Rupees.

Even prior to the starting of the Oudh Commercial Banking Co. (1881), there were indeed a very large number of small banks and loan companies with a small amount of paid-up capital. The following table shows some of the earliest loan companies still conducting business at the present-day without interruption :—

Name.	Date and year.	Authorised capital. Rs.	Subscribed capital. Rs.	Paid-up capital. Rs.
Barisal Loan Office	17-11-73	20,000	18,000	18,000
Bogra ,, ,,	5-11-74	60,000	59,030	59,030
Dacca ,, ,,	29- 3-80	1,00,000	69,200	62,200
Faridpur ,,	4- 3-71	20,000	19,820	19,820
Jessore ,, ,,	12-4-76	1,20,000	1,00,000	1,00,000
Munshiganj Loan Office	29-7-76	20,000	12,060	12,060
Mymensingh ,, ,,	2-9-73	1,00,000	80,400	80,400
Nasirabad ,, ,,	24-9-75	50,000	45,000	45,000
Sahar-Sharpar ,,	26-6-76	20,000	16,210	16,210
Tipperah Loan Office	25-2-71	1,00,000	1,00,000	1,00,000

Small banks of South India.

It was not only in Bengal that such concerns existed. In the Native States of Mysore and Travancore several small banking concerns were started in 1875 and the Bangalore Bank though under non-Indian management was started in 1868 and is still conducting sound business under able management. Even now several of these small banks exist in South India and these should on no account be confused with the *Nidhis* and *Kuttee-chitti institutions.*

Working Capital.

A glance at the above table quoted from the blue book shows how ridiculously poor is the *paid-up capital* of these loan companies.[1] The tendency of the smaller banks of South India is also small. Some of them have succeeded in attracting huge deposits by paying oftentimes high deposit rates of interest,[2] but as the Statistical Department does not publish the figures about their deposits, advances and other banking operations it is not possible to have an idea of their working capital [3] or the magnitude of their operations.

Unfettered competition.

Another peculiar feature is the presence of a large number of these companies, as many as five to seven of these isolated small loan companies, which are working in a restricted locality on mutually antagonistic lines. Bogra, Comilla, Faridpur, Gaibandha, Jalpaiguri, Jamalpur, Jessore, Khulna, Kurigram, Madaripur, Mymensingh, Rajshahi and Rangpur have a number of loan companies working over a delimited

[1] The C. B. Enquiry Committee says that 782 loan companies existed in 1929 in Bengal.

[2] See the Tables compiled by the C. B. Enquiry Committee, Report, Appendix II, pp. 733-784.

[3] See the Report of the Provincial Banking Enquiry Committee. Normal rates are 1 to 8 per cent. for a period of 5 years, sometimes 15 to 20 per cent. interest rates are paid. Touting for deposits is too common.

local area.[4] The same is the case with the small banks of South India. Bangalore, Calicut, Chamrajnagar (Mysore), Palghat, Raichur, South Canara, Tellicherry, and Tinnevelly have a large number of these small banks in addition to Nidhis and Chit Funds. It is indeed strange to find that the premier Native State—Hyderabad has very few only of these indigenous banks of its own. The District of Mymensingh in Bengal has on the other hand the largest number of these loan companies and about 80 of them exist in this populous and wealthy district.

Rationalise the banking industry.

While the rationalisation of every kind of industry is progressing at a rapid rate in every economically progressive country there is no such desirable move in our banking business. Although a few instances of spontaneous banking amalgamations occurred in the past with desirable consequences in each case of amalgamation, the movement unfortunately has not spread to the loan companies of Bengal. The necessary unification of the individual loan companies and small banks has not taken place so as to create a comparatively small number of powerful business units possessing the three canons of soundness, adequacy and efficiency which any sound banking company should possess.

As a consolidated balance-sheet of the loan companies cannot be presented, nothing beyond a rough idea can be gained by studying a typical balance-sheet of a loan company.

Liabilities.	Rs.	A.	P.	*Assets.*	Rs.	A.	P.
1. Due to Share	35,474	0	0	1. Cash in hand	4,963	6	11
2. Deposits by members	26,291	0	0	2. Cash certificates	7,534	6	0
3. ,, non-members	51,445	12	3	3. Land and buildings	6,126	15	6
4. Unpaid interest	2,309	2	3	4. Principal due	10,684	14	0

[4] The Bengal Banking Enquiry Committee says that these 782 loan companies of Bengal had about 9 crores worth of capital on March 1929.

Liabilities—contd.	Rs.	A.	P.	*Assets*—contd.	Rs.	A.	P.
5. Unpaid dividend	2,474	11	0	5. Interest due	5,262	3	0
6. Due to office expenses	103	8	0	6. Discount	30	0	0
7. Excess collection to be returned	14	6	0	7. Present price of furniture	337	8	0
8. Provident Fund	233	8	6	8. Postage stamps in hand	4	10	6
9. Suspense deposit	21,887	14	0	9. Due from pleaders	244	9	6
10. Reserve Fund	9,100	0	0	10. Costs of suits due	1,378	9	0
11. Building fund	1,719	10	0	11. Interest due from post office	79	1	3
12. Bad debt fund	2,400	0	0				
13. Building depreciation fund	200	0	0				
14. Excess undivided profit	36	10	2				
Total ...	1,34,800	10	5	Total ...	1,37,146	3	8
Profit ...	2,345	9	3				
	1,37,146	3	8				

Their Defects.

Some of the acknowledged defects of the loan companies are the lack of proper book-keeping methods, a staff of trained bank officers and whole-time bank directors who devote their energy solely to the banking profession. They lend on the strength of their own share-capital. Very often the managing directors pack the Board of Directors with friends of their own choice and real election of directors by the shareholders is not generally the rule. They do not encourage the *free use* of credit instruments like cheques and bills of exchange. Short-term deposits are not cared for and the matter of withdrawing funds is not satisfactorily attended to as keen competition exists for deposits and a high deposit rate of interest is offered by them. The margin of profits is generally very narrow. There is no limit to the number of directors and promoters. Sometimes there is interlocked directorate. They lend on mortgage of immovable landed property or personal security or carry on side-business such as motor transport and conduct

ordinary banking business for the small middle class salaried people. Some of the loan companies are already finding it difficult to keep funds safely employed at interest for most of them do not possess more than one office. There is no proper provision for reserve fund and no limit exists for the distribution of profits. The small local autonomous and independent banks and loan companies keep scattered reserves and unless they are also included in the banking re-organisation, the efficiency, economy and safety of centralised reserves would not be forthcoming. The constant failure to achieve any substantial and useful purpose except that of declaring successful dividends is due to the disorganised condition of the loan companies and their failure to develop internal trade and cottage industries of the province.

Many of the defects have been aggravated by the depression leading to the freezing of the assets. The middle class people of rural Bengal have been badly hurt thereby. About 57 of them failed during the course of last six years.

Proposed line of action.

To secure improved banking safety and the provision of sufficiently varied facilities both internal and external machinery must be devised. The internal line of action consists in putting an end to the disorganisation and uncoordinated action on the part of the loan companies which are very tenacious of their existence. The amalgamation movement gives the clue to the necessary action that has to be taken to cure these evils.

The external line of action consists in setting up a Central Bank of Issue which can make its reservoir of credit easily accessible to the better organised units. Both the above lines of action are fundamental and the internal problem is even more important than the external and brooks no delay. Without such previous preparation the creation of a Central Bank of Issue would leave these structures as they are at present. Unless they become respectable and conservative concerns specialising in an intelligent manner either short-term or long-term loaning business thus becoming more rational in the distribution of their risks, the Central Bank of Issue which would essentially be a bankers' bank would have nothing to do with them. A Central Bank

will agree to deal with banking institutions conducted on well-regulated business principles.

The example of the United Kingdom.

A glance at the progress of the English banking system reveals the trend towards amalgamation and reduction in numbers as a marked feature of the past few years. The rapid and epic development of banking amalgamations in the United Kingdom represents a series of triumphs. Without any violent attempt to eliminate healthy rivalry and desirable competition the movement has ended in creating a very small number of large and powerful banking concerns.

Different economic causes operated to produce this drive for banking amalgamation.[5] The stimulation of the important economic causes such as increasing business was responsible for the country banks to amalgamate with the London banking concerns. The over-production of a few concerns made them consider amalgamation as a proper means of securing an outlet for their huge loanable funds. Circumstances of many kinds operated to initiate and spread this movement. The Government of the United Kingdom have on the whole consistently adopted a favourable view and permitted all cases of amalgamation which would not injure the interests of the country or the investing public.

The concentration movement in Germany.

Even in Germany [6] the necessity to strengthen and extend the exceptionally weak foundation of capital and credit forced the pace of the amalgamation movement. The main principle of banking, *viz.*, the distribution of risks is the foster-mother of this movement. The business of issuing securities accelerated the pace of the movement and the Berlin banks strove to gain the custom of the provincial bankers. Misguided Stock Exchange legislation, stamp duty, etiquette and competition forced the German banks to establish their branches, increase their capital and the concentration movement was fostered by

[5] See J. Sykes, " The Amalgamation Movement in English Banking," pp. 16, 17, 45, 46, 92 and 93.

[6] See Dr. Reisser, " The Grossbanken," pp. 602-702.

these non-economic forces as well. The economic power of private banking to cope with increasing trade and industry was restricted and this acted as a cause in hastening the movement towards the bank amalgamation. The crisis of 1873 and 1900 in Germany pointed out the necessity of efficiently-managed banking institutions. The large banks which intervened effectively soon absorbed the smaller and weaker banks. We cannot enter here fully into all the causes economic and non-economic, that brought about the amalgamation movement in German banking. But the main result is that as in industry the *forms of cartels are protean* so also there are bank affiliations, working agreements and complete fusions.

The Results.

The happy result of such movement in both countries has been the improvement in banking technique. Reliable and competent management has ensued so that economic benefits have been reaped in most cases. Credit resources have been pooled and extended to more efficient men than before who are able to make a scientific allocation of credit for productive purposes. Progress, economy, strength and prosperity have been the chief results of the movement. A desire to realise these advantages is also visible in the American banking system and several amalgamations have recently occurred in the American banking field.

Impossibility of amalgamation with bigger banks.

The weaknesses of the present-day loan companies are admitted by all people. There are only two ways of remedying the weaknesses: (*a*) by mending them, (*b*) by ending them. The latter alternative cannot be thought of as it leads to the shrinking of the credit structure. Amalgamation with the stronger banking companies cannot be thought of for the bigger banks would not care to consolidate their position by amalgamating with such bodies as those who resort to comparatively long-period loans on the security of real property. The bigger banks

[7] See the Literary Digest, May 25, 1929.

usually follow a cautious policy of lending on first class liquid securities. This tendency to tie up the resources would lead to failures and so long as the policy of borrowing short and lending long is persisted in there can be no thought of amalgamation as a remedy. Larger and better-managed banks are essential to finance the existing and the would-be expanding needs of agriculture, trade and industry.

How can the essential needs of developing the credit resources of Bengal so as to cope with the demand on the other side be met without changes in the credit situation? The revivification of industry and trade and rural economic organisation depends on adopting this movement.

The Main Advantages.

The reduction of costs even if the branches of a large bank are started over the whole province would be a desirable end by itself. Additional deposits can be secured by the larger banks. With augmented resources propaganda can be carried on by the banks for tapping the small individual and dormant hoards. They would be in a position to meet the competition from rivals abroad. The evils of present-day unfettered competition among the loan companies must be realised and the best way of coping with the situation is to co-operate. Better organisation of the technique, perfecting the services to depositors and borrowers, an extension of credit facilities to all deserving people and the introduction of rational business methods and accounting by a competent and trained staff are things which larger banking units alone can hope to accomplish. The standardising of interest charges, commissions, fees and services to customers over the whole of the province can be considered as the most outstanding gain of the amalgamation movement.

Other expected advantages.

It would furnish a basis for the establishment of branches. There would be much needed decentralisation of activities of some of the overgrown loan companies. The more or less unsuccessful of the loan companies can hope to accomplish more by an amalgamation with

the more successful ones. The larger banking units can create adequate credit resources that are needed if a unified programme of developing trade and industry and promoting the general economic interests of the province is drawn up. A host of scattered medium-sized loan companies would accomplish very little success in the above direction. The extension of cheque business and clearing facilities would lessen the need for cash payments and promote increased freedom of action in the money market. Larger banking units can place better and more reliable credit information in the matter of bills, payment and foreign exchange than what the smaller loan companies can afford to place at the disposal of their clients.

The decline of the indigenous money-lenders' importance may also represent another desirable consummation to be striven for by every well-wisher of the country. At any rate the opportunity of building up private money-lending business would be restricted. The amalgamated loan companies can easily widen the appr.ach to the possession of a banking account.

The social obligations towards employees can be better attended to by the larger units than the small individual banks. The present average salary paid to the clerks of the loan companies is far too inadequate for the service rendered by them and if we are to free them from temptation to borrow funds all financial worry and anxieties are to be removed by paying a fair wage for fair outturn of work. For the present there is the absence of exploitation of unpaid apprentices which the larger banks of the metropolis (Calcutta) are at present doing. The Institute of Bankers can get better regulations of service recognised by the amalgamated banks.

A steadier rate of dividends and increasing size of customers would have its psychological effect and the amalgamation movement would doubtless gain further momentum. The press and the public can easily influence the policy of the larger units than an indefinite number of small scattered banking units. The amalgamated banks can keep alive certain efficient key industries which are important to our national existence and even at the cost of some economic consideration the stimulation of such key industries is essential.

Unwholesome and unnecessary competition with the co-operative movement has tended to dwarf its growth and the co-operative movement of this (Bengal) province has not progressed so favourably as in

the Punjab, Bombay or Madras. In spite of diversified activity in the field of non-credit co-operation such as in the matter of production, irrigation and anti-malarial societies, the financial resources at the back of the credit aspect of the co-operative movement would have been far larger than is the case at present. This is a sheer loss of energy and waste of money.

Small loan companies acting as separate units would suffer from fundamental defects. The province of Bengal cannot boast of enough talented banking management to supply several hundreds of banks with able direction. Again effective supervision of hundreds of banks is an impossible task for the regulatory authority. The desirable degree of diversification of business does not exist. The weaknesses of the unit banking system experienced by America are being reaped on a larger scale by the Province of Bengal on account of the existence of too many small independent loan companies.

The amalgamation movement would easily extinguish and absorb what is objectionable and dangerous in the haphazard and ill-balanced loaning methods of the present small-scale banking establishments. The present tendency to combine both short-term credit and long-term credit without adequate preparation to meet the depositors' call is wilful negligence of the sound canons of commercial banking.

There would be increasing development of demand on the part of the Government, the municipalities, and the district boards, etc., for capital. Hence greater banking units are essential and the evolutional trend of development in international and foreign banking points out this tendency. It is taking place elsewhere rapidly in a reasonably orderly manner. Bengal has to move with the times. It must move with the stream or be left behind.

Such then is the brief outline of some of the advantages arising out of the amalgamation of the loan companies of Bengal. It is a matter of gratification that the Bengal Banking Committee favours the amalgamation movement recommended by me.

Can the proposed Bengal Federal Bank stem the tide ?

The formation of the Federal Bank or Big Financing Corporation for the loan companies is indeed a less drastic remedy than the adoption of the amalgamation movement which can only be accomplished

over a long period of years and perhaps with doubtful results if it is not carried out in the proper way. Preserving the complete internal autonomy of the loan companies the Federal Bank offers less violent changes in the banking reorganisation than would accrue if the amalgamation movement is to be encouraged. Whether they exist as at present as small independent bodies or become welded into large units it is essential that they should pursue vigorous advertising campaign for deposits and provide at the same time convenient facilities for withdrawing the same and take adequate precaution for protecting the deposits. Can the Federal Bank be considered a substitute for sound banking practice ?

The essential idea of the Federal Bank itself is to secure a loan combination to expand and regulate credit facilities for the common pursuit of interests such as promotion of trade and industry. I would substitute absolute and complete fusion of the different loan companies operating at the different centres into one big bank and at the top there would be the Central Bank of Issue and direct access to it would not be denied. Such real banking concerns should arise instead of the present money-lending concerns which they tend to become as a result of unenlightened management.

Unwholesome competition is a great evil and with greater resources secured by access to the Federal Bank they would still further [8] compete so that the axe may fall even on the most efficient. Which is preferable—stagnation, slow and painful process of extinction or the resurrection, reconstruction and rationalisation of the banking business arising out of amalgamation ? Of what avail is an overgrown, unmanageable and uncontrollable loan company finding it hard to maintain a productive investment of its loanable money ? Some of the loan companies are finding it difficult to establish the equilibrium of the balance-sheet without sacrificing the liquidity of their assets. Unless the widening of the area of their activity takes place stagnation alone would be the inevitable result. Since these lines have been written some of the Moffusil loan companies have followed this advice and have opened branches in Calcutta. They must issue

[8] It is on this ground that the suggestion of creating an " apex " bank as financing corporation for the loan companies, which has been suggested by the Bengal Provincial Banking Enquiry Committee, has to be discarded.

pass books and grant receipts in proper form so as to generate public confidence and secure stability. Standardised credit instruments must be used by them.

Is there any certainty and guarantee that accommodation will be made by the Bengal Federal Bank without undue favouritism ? It is not only essential that the Bengal Federal Bank should pay due heed to ' intrinsic soundness ' of the borrower's security but the due claims of other member-borrowers would have to be borne in mind. Would there be this impartial attitude in extending credit to different member banks ? Would there be ample resources at the back of the Bengal Federal Bank to bring about a just, equitable and adequate distribution of the same amongst the different member-borrowers ? The Bengal Federal Bank should attract long-term deposits. As enough work can be found for both short-term as well as long-term resources the Bengal Federal Bank should be capitalised on a big scale. Although it is proposed to grant loans to members alone and no dealings with the outside public are contemplated still the demand for long-term credit can be great. Short-term credit can be easily granted and as new avenues for it in the shape of demand for remittances, discounting bills, and making advances for financing crops and enabling the agriculturists to hold up their crops against low prices would be found the nightmare of too large capital should not haunt the minds of organisers. On the other hand if it is undercapitalised no appreciable results would be secured under any direction. Success is always on the side of big battalions.

An efficient system of supervision of the individual loan companies should be established as it is contemplated to advance small sums without taking any collateral securities from member-borrowers. It should act as a guiding, controlling and co-ordinating force so far as joint interests are concerned. The individual independence of the loan company is in no way assailed but the definite guidance and watchfulness of the Federal Bank would be of great help to them. The individual small loan companies can secure ready financial support from the Bengal Federal Bank. As an emergency improvement it would prove very suitable for weathering any financial disturbance arising out of the depositors' nervousness. But as a permanent remedy for all the evils that loan-companies are at present subject to it is doubtless inferior to the suggestion of a Central Bank of Issue. This

is far more preferable to the starting of a federal bank for loan companies alone. In case of the C. Bank of Issue the Act of Incorporation may be specifically framed so as to forbid discrimination in favour of or against any member bank. The aim of a Central Bank is to aid all branches of economic activity, the producer, the manufacturer, and the farmer with absolute impartiality. Its elastic note-issue would enable it to meet the legitimate demand for genuine credit expansion. Its periodical scrutiny of the member-borrower position would tend to elevate the standard of banking into a higher plane. Its greater strength, authority and scope would enable the Central Bank to bear any additional burden and if the larger loan companies co-operate with the C. B. of Issue the problem of banking reorganisation would be easily solved.

Why not depositors as directors?

Although the Bengal Federal Bank is to be a bankers' bank individuals are permitted to own shares and be elected to the Board of Directors of the Bengal Federal Bank. Though the constitution of the Board of Directors would be of a mixed type consisting of individuals as well as representatives of loan companies it might fail to inspire the depositors with any amount of confidence. Throughout the history of Indian banking the most noticeable feature has been the lack of confidence which the depositors always evinced at crucial times, with the result that even sound and solvent bankers who committed the fault of locking up short-dated deposits in long-dated loans came to grief. Doubtless many depositors would be attracted towards the Bengal Federal Bank and it should boldly come forward and secure legal permission to incorporate the following suggestion. Directors can be elected to represent the depositors and if these sit on the Board of Directors [9] the depositors would feel some sort of protection and as this matter can be easily arranged no opportunity should be lost to adopt this salutary practice in the Federal Bank's operations after securing the necessary legal permission to do so. As the present Indian Companies Act does not permit any other than a shareholder to be a director this innovation cannot be secured but if

9 Such a thing is permitted in the field of the Banking system of Denmark.

the Federal Bank seeks a separate Charter of Incorporation containing this special feature as one of its statutes it would go a long way in pouring oil on troubled waters.

The Bengal Bankers' Federation.

Thus far the advantages flowing out of the activities of the Bengal Federal Bank and its inferiority to our suggestion has been pointed out. Coming now to the non-financial activities of the Bengal Banker's Federation, the following aims of the same should be borne in mind.

The aims of the Federation.

Broadly speaking, the main aims of the newly started organisation are threefold in number. Firstly, it is proposed to form a permanent and authoritative organisation for the constant review of all aspects of banking and promote its development on sound lines by inculcating measures leading to the wide diffusion of banking knowledge, by limiting or securing legal measures conducive to the best interests of the indigenous banks and their business by adopting uniform and standardised forms of contracts, etc., and promote banking intercourse among practical bankers and others interested in banking. Secondly, it aims at the elevation of the technical knowledge of bank officers in actual charge of practical banking business thereby lessening the scope for bank failures due to inexperienced and injudicious banking. Thirdly it proposed to found a bankers' bank which would be of substantial use to the banks and loan companies of Bengal and ensure the free flow of capital from the metropolis to the Moffusil and *vice versa*. Another laudable object is to promote the continuous investigation into banking problems of our country and publish the results of the investigation and other facts bearing on all problems that concern banking business so as to guide the people conducting practical banking work on sound and unimpeachable lines. Still another function which would add to the material progress of the province is the attempt to organise Stock Exchanges in prominent centres and promote the investment habit on the part of the people.

General long-period effects.

A cursory glance at the different aims of the Federation would reveal the fact that if it is successfully worked and if concrete and decisive action is taken according to the plan it is bound to have some beneficial influence on the financial progress of this province. It is nothing but a co-operative effort on the part of banking experts and practical people in touch with banking to prevent mismanagement of banking business often resulting out of incompetency or ignorance. The proposed object is to prepare the ground for co-operation between the different isolated banking and loan companies working in the interior of the province and enable these loan companies which roughly number about 800 to take concerted action in common matters which may effect them vitally. The best form of credit policy and financial organisation needed for the province can be created as a result of its deliberations.

It has become indispensable in every walk of life, be it money-lending or business endeavour or pleasurable undertaking, to co-operate with each other and establish a joint permanent organisation for the purpose of securing the desired ends and aims. If a new banking era is to be started in the province it is high time that this Federation should be recognised officially.

Business efficiency and business statistics in the field of banking would not be forthcoming without the assistance of such a federation as this. Effective publicity and presentation of Banking statistics in place of present secrecy would create stability and confidence. Like the British banks the Indian Banks lag far behind the American banking institutions in the matter of publicity.

The Bengal Bankers' Federation should follow the American Banking practice and seek to publish its facts and figures. Banks like other institutions do not stand to gain anything by placing their light under the bushel. It should likewise follow some of the salutary measures adopted by the American Bankers' Association in the development of agriculture.

The necessity of active propaganda and continuous action must not be ignored. Many of the Agricultural Associations of Bengal are in a state of suspended animation. Better banking knowledge, better

›anking service, and better financial facilities are essential. With eference to the provision of common aims such as better banking :nowledge it is its bounden duty to co-operate with the All-India Institute of Bankers which was started just the other day at Bombay nder the aegis of the Imperial Bank of India.

Since the above lines were written the scheme of the Bengal 'ederal Bank and the Bengal Bankers Federation have vanished ıto thin air. Nor has the suggestion of the financing corporation ıade by the Banking Committee materialised. Instead of that we nd the leader of the B. N. Chamber of Commerce vainly appealing ɔ the Central Bank of India to help the frozen loan companies in ıe matter of liquefying their assets. There are others who suggest ıore detailed regulations for loan companies so as to limit the amount f deposits which can be attracted, to prohibit loans to directors, to mit the payment of directors' fees to the directors in proportion to rofits earned, to get the accounts audited by Government-appointed ıditors, and to provide for the compulsory formation of reserves so s to meet unforeseen losses.

Difficulties in the path of the amalgamation movement.

The amalgamation would indeed be of slow and gradual growth nd in the first instance it should be confined to the union of all loan ɔmpanies in one and the same local area. There would be difficulties, ɔmplex questions and burdensome details which would have to be ›lved in the matter of securing this desirable consummation. Given ı enlightened leader the process can be discussed and arranged for ıd success can be achieved. By holding conferences the directors ın appreciate and learn the basic facts of the situation and if ›ecialists are consulted the question of fusion would no doubt be ısy. Concentration in banking is always easier than in the case of ıdustrial companies and their different plants and establishments. ɔund leadership, breadth of vision, spirit of give and take and desire collaborate and the placing of more reliable information by the ·esent over-secretive directors are essential for the success of the ovement. The satisfaction of the shareholders can be easily arranged hen proper valuation and conservation of the investments are made ' the promoters. The abnegation of personal jealousies and ambitions

and the pursuit of general good are essential to carry out the amalgamation movement. The inherent good sense of the shareholders would not fail to make them realise the consequences or the end of the amalgamation itself. The state can facilitate the movement in many ways. Stamp duty may not be charged whenever a mere incorporation of the loan companies is made under a new company. When fresh capital is attracted the stamp duty may be levied. Special rebates and allowances were granted in Germany to enable the steel merger to take place. In some cases the previous British Governments allowed similar concessions in case of industrial companies, *viz.*, railways and mines in England. Such a favourable attitude would undoubtedly facilitate the progress of the movement.

Conclusion.

A good impetus can be given to banking and all other industries dependent on it by a sympathetic handling of this idea. It is only by such an enlightened policy that the long-term credit needs of landlords can be met in this province. Several of the larger or amalgamated loan companies can specialise in mortgage business [10] and with some amount of caution conduct successfully this land mortgage banking as some of the joint-stock land banks are doing in the U. S. A. This can be linked to the P. L. Mortgage Bank when it is started. Others might elect to specialise in short-term loans to agriculture, trade and cottage industries of the localities. Consumption needs can be encouraged by some who might develop instalment sales and methods. Unless there is specialised attention [11] and rational and systematic division of labour in the matter of credit facilities by each re-organised larger loan company, the cry for state aid and state control over the present loan companies is bound to be repeated. Greater functional specialisation among the larger loan companies affords the proper key to the solution.

[10] The Hindusthan Co-operative Bank specialised in lending on building property.

[11] Mr. N. R. Sarkar insists on this much-needed credit specialisation on the part of the loan companies. His suggestion is that some of them should follow the working model of the Building societies and Friendly societies of the West.

Frankly stated there is not much immediate justification in organising co-operative land mortgage banks for long-term credit because the landlords make little demand for long-term credit for agricultural improvement purposes and this they cannot do in the near future even, as there are co-sharers in land. Advancing credit in competition with the present loan societies is dangerous. It would undoubtedly lead to the making of unsound loans and undue lowering of the rate of interest which may be beneficial to the borrower only if a right use of easy and cheap credit is made. It would however spell ruin to the competing institutions. Unless the whole situation is studied carefully the starting of the co-operative land mortgage banks should not be thoughtlessly done. Theoretically speaking, the organisation of long-term credit tending to reduce the rate of interest would be a boon to the owner-agriculturists but in Bengal at present this is not immediately possible or feasible. Our serious endeavour should be in the first instance to study the present-day position of the loan companies of Bengal and give them a recognised and useful place in the credit system of this province. It is sheer folly to force this private enterprise out of business by starting a brand new organisation. It is the unsatisfactory state of these small banks and loan companies that makes one suggest banking legislation and enforce it by public inspection.[12] It is the mistakes of these that recoil on the head of the bigger joint-stock banks however prudently they might be conducting their practice.

Some of the loan companies might act as "Morris plan banks." Some of the loan companies might be developed into investment agencies specialising in this line. Some of them might undertake commercial banking and acceptance business and improve the

[12] Since these lines have been written the Provincial Banking Enquiry Committees have not only endorsed the Amalgamation idea but in order to check the defects, they suggest the fixing of minimum paid-up capital, the prohibition on lending on their own share capital, investment of reserve funds in P. O. Savings banks, the separation of subsidiary non-banking business and the checking of widow-dressing tendency of bank balance sheets. These can be tacked on to the general banking regulations that might be enacted in the near future. A separate loan office regulating Act may not be necessary. Banking is a federal subject and any provincial legislation in this field should be deprecated for it might break the uniformity of conditions and tempt the flight of capital from one province to another.

methods of marketing and financing prevailing in the internal trade centres. Some of them might undertake long-term lending like that of joint-stock land banks of the U.S.A. Provided they co-operate with the Apex Provincial Land Mortgage Bank which would be started in due course of time in this province and the co-operative credit societies of their particular localities they are bound to meet with success. It has to be remembered that originally some of them were started along the lines of land mortgage banking. Some of them might undertake functions similar to those of building and friendly societies of Europe. Some of them might develop industrial financing of a type suited to the growth of the cottage industries existing in the province. Some of them might develop into finance companies specialising in the granting of consumption loans to enable people to purchase the industrial products. Some such suitable reorganisation of the loan companies should be secured with the active co-operation of the co-operative, agricultural and industrial departments of the Provincial Government. Reorganisation wtih the view of consolidating and co-ordinating their mutual activities would be absolutely needed to stabilise the position of the loan companies.

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CHAPTER X

THE INDIGENOUS BANKER OF INDIA

The etymology of the word 'bank'—The meaning of Banking—The development of banking in England—The origin of banking in India—The past status of the indigenous bankers—Contact with Western civilisation—Several names of the indigenous bankers—Functions of the rural indigenous bankers—Comparison of their money-lending policy with that of the Western banking methods—The banking habit—The shroff or the urban banker—Rediscounting trader's bills—The Bazaar rate—Non-credit functions of the indigenous bankers—Organisation of their business—Their public spirit—Indigenous bankers' associations—Is it wise to deprive the shroff of his deposits?—An elastic system of rural credit—Educate the rural borrowers—The present position of the indigenous anker—Defects of the indigenous bankers—Why has the indigenous banker failed to become a modern banker?—Suggestions for improving the indigenous banking system—Other quasi-banking institutions—Their future.

The Etymology of the word "Bank."

The terms 'bank' and 'banker' are quite modern but the profession is a time-honoured one.[1] The word 'bank' was a German term signifying a joint-stock fund. The Italians used the word "banco" meaning a heap of money or an accumulation of stock. The common derivation of the word 'bank' from the counter upon which the Italian "money-changer" used to lay out his stock has been ridiculed by H. D. MacLeod[2] on the ground that the Italian money-changers as such were never called 'bancheri,' in the Middle Ages. Whatever might be the real origin of the word 'bank' we see that the etymology of the word "bank" suggests an origin which would trace the history of banking in Europe from the Middle Ages.

The meaning of Banking.

Originally banking had its origin in the efforts of individuals to supply certain primitive wants of an advancing community namely

[1] According to the French writer M. Revilpout there were banks and bank-notes in Babylon, six centuries before the time of Jesus Christ. See B. Nogaro, "Modern Monetary Systems," p. 163, foot-note.

[2] H. D. MacLeod, "Theory of Credit," Vol. I, p. 90.

lending and receiving deposits. The process of satisfying their wants was by means of a few perfectly simple operations. But with the evolution of time these individual wants sank into insignificance and the unforeseen, much-disputed and ulterior effects of a banking system became recognised. The primary and original functions of banking namely lending and receiving deposits are still the more important functions but a great variety of services are performed by modern banks. With the advent of specialisation due to the progress of society we find a diversity of banking operations as well as institutions. It has fallen to their lot to finance industries, to liquidate the international indebtedness, to manipulate the currency system and lastly to mobilise credit which furnishes the life-blood of trade and commerce. It is futile to catalogue the range of facilities offered by modern banks to the community nor is this the proper place to indicate their limits.[3]

The Development of Banking in Europe.

According to C. A. Conant the forerunners of modern bankers were " the individual money-changers, the Jewish money-lenders, and the Lombard bankers." As industry expanded by leaps and bounds, as centralised government emerged out of the welter of political chaos and as national life became organised the necessity for public banks arose. The Bank of Amsterdam was organised to remedy the defects in the currency circulation of Holland. The Bank of England would not have been ushered into existence so soon but for the necessity to finance the Dutch Wars of William III, King of England. So European banking understood in its modern sense is barely three to six centuries old. But India on the other hand had a widespread banking organisation some centuries before the term modern "bank" had been coined.

The origin of " banking " in India.

Evidence is forthcoming in abundance that the business of banking was perfectly understood by the people of ancient India and fairly

3 For a brief enumeration of the important economic services of banks, see my ' Elementary Banking," Section on " Economic Services of Banks."

practised by them. In early times the guilds of individuals issued coins as well as credit instruments. Dr. S. V. Ketkar speaks of eighteen guilds of different trades and the Mahasethes arbitrated in matters of dispute between the different guilds.[4] Dr. Pramathanath Banerjea quotes from Gautama, Brihaspati, and Baudhayana verses which regulate the rate of interest.[5] The institutes of Manu give us rules regarding the rate of interest and the policy of loans.[6] Kautilya offers some interesting advice on these points.[7] Sir W. W. Hunter gives us valuable information as to the manner in which a private banker sets up his business.[8] The practices of the village bankers of the early part of the 19th century are dealt with in detail by Mr. A. F. Tyler.[9] Mr. Thorburn describes vividly the "greed of gain" on the part of village "banias" of the Punjab and the methods of operation which tended to reduce the agriculturists into a state of abject slavery[10] Some glimpses of the indigenous system of money-lending and banking can be obtained from Mr. Malabari's account of Guzerat.[11] Sir Richard Temple testifies to the fact that banking business was carried on by our ancients. He estimates "the number of bankers to be one hundred and eighteen thousand of which some are money-changers. There are half a million villages and there are about two bankers to every village."[1] The recent Census of India estimates the number of bankers to be about 1,461,000 but it includes bank managers, money-lenders, exchange and insurance agents and money-changers. Speaking of their locale it remarks that "banks and money-lenders are plentiful in the Punjab, their number exceeds the general average in Bombay, the Central Provinces and Berar and the United Provinces while in

4 See S. V. Ketkar, "History of Caste in India," Vol. I, p. 33.

5 See Dr. P. N. Banerjee, "Public Administration in Ancient India."

6 See Burnell and Hopkins, "Ordinances of Manu."

7 See Kautilya's "Arthashastra"—R. Shama Shastri's Translation, Book III, Chapters XI to XIII.

8 See the Imperial Gazetteer of India, Vol. IV.

9 See "The Considerations on the present Political State of India," 1815, 2 Vols.

10 S. S. Thorburn, "Mussalmans and Money-lenders of the Punjab," Chapter VII, pp. 54-72.

11 See his "Guzerat and the Guzeratees."

12 Sir R. Temple's Lecture before the Institute of Bankers, London.—Journal of the Institute of Bankers, Vol. II, 1881.

Assam it is only 1 per mille." [13] Epigraphic evidence as regards the prevalence of banking in Ancient India can be cited from the pages of the Indian Antiquary. Dr. Radha Kumud Mukherjee cites both literary and epigraphic evidence as regards the prevalence of banking in ancient India.[14]

Lack of data and precise knowledge.

Barring a definite exposition of the organisation and methods of banking and money-lending no analytical method of study and practices of the indigenous banking system can ever be written as there are *no published figures of their operations.* No accurate knowledge and real understanding of the precise issues solved by the indigenous bankers can be forthcoming due to paucity of relavent materials. No statistical information of their business has been collected by the previous rulers. Even now the situation is not improved to any extent.

The lack of political tranquillity for a number of years must undoubtedly have told very seriously on the banking houses in the different parts of the country. The indigenous bankers plied another occupation notably that of merchant or trader and shop-keeper. Investment in real state was the most common occupation in addition to banking business. *A banker qua banker* did not exist in the past. Even now the situation is not wholly changed. It is seldom that they restrict themselves to ordinary banking business. They perform a multiplicity of operations and this renders difficult the study of the methods of the indigenous bankers. The word " banking " is loosely used in the sense of mere money-lending even upon security such as real property, agricultural produce and industrial products. The loss or decline of their hundi business and agency business due to export firms having their own branches have to be tackled.

The past status of the indigenous bankers.

Many of the indigenous bankers held high political authority at the Mogul Courts, specially towards the closing years of the Mogul regime. The advent of the British Rule has no doubt deprived him

13 *Vide* the Census of India, 1921, Vol. I, Chapter on " Occupation." The previous estimates in 1901 and 1911 were 1,156,000 and 1,128,000 respectively. For 1931 Census figures, see Supplement to the Gazette of India, 19th Sept., 1931, pp. 562-563.

14 See Dr. R. Mukherjee, " Local Government in Ancient India."

of his political importance and prestige. The political influence of Jagat Seth [15] and Omichand during the Plassey Days is well-known, to

[15] A brief history of the House of Jagat Seth.—The founder of the house was a Marwari Raiput who immigrated from Jodhpur somewhere about 1695 and settled in Patna and began money-lending business. His seven sons migrated to different parts of Bengal. The eldest son, Manik Chand, migrated to Dacca and became the Court financier of the Dewan Murshid Kuli Khan, the founder of the house of Murshidabad and to him was given the title of Seth. His adopted son, "Fatechand," was given the hereditary title of Jagat Seth "or the banker of the world." Fatechand was a member of the Council of Shujahuddin Khan and was largely instrumental in installing Alivardi Khan in the place of Sarfaraz Khan who insulted the honour of a lady of his house. The next bankers to control the firm were Mahabat Rai and Swarup Chand. The finances of Bengal lay in their hands. "The pay of the army and civil administration depended on their honouring the orders for payment made by the Nawab. They stood security for revenues of farmers and regulated the rate of exchange—being according to a letter sent by the Calcutta Council to the Court of Directors in 1753, the sole purchasers of all the bullion imported into Bengal." Orme says that the "French East India Co.," at Chandernagore was indebted to them to the extent of 1½ millions of Rupees. He also states that Alivardi Khan received a present of 3 lakhs of Rupees from the Seth as a contribution to support the expenses of the Mahashratta war." In the year 1742 they felt the first stroke of ill-luck when a Maharatta horde—part of Bhonsle's defeated army at Burdwan,—swooped down on the house of Jagat Seth and carried away two crores of Arcot Rupees. In spite of the loss they carried on their banking business and in 1749 they lent the English 12 lakhs of Rupees. From this date their influence is to be noticed in the affairs of the English East India Company in India. Nawab Surajdaula on account of his cruelty and injustice soon became unpopular and fell out with his banker the Jagat Seth who refused to raise three crores of Rupees from the European merchants. His open insult to him in the Durbar led to the latter's intrigue with the English officers of the East India Company. According to the French writer Law the Jagat Seths were so powerful that they could have installed a new Nawab on the throne without the help of the Europeans but as time was of importance the Seths who feared the confiscation of their wealth had to join hands with the English who were anxious for their very safety. It was in the house of Jagat Seth that Watts, Walsh and Scrafton met the ill-fated Aminchand to work out the details of the plot by which Mir Jafar hoped to obtain the Subaship of Bengal. The Jagat Seths continued to flourish under the new Nawab and their relations with the English became more friendly. When Jagat Seth revisited Calcutta in 1759 the English entertained him at a cost of 12,000 Rupees.

When Mir Kashim came to the Musnud he did not tolerate the friendship of the English and after the recapture of Patna from Mr. Ellis he drove every Englishman out of the dominion and conveyed the bankers to Mongyr. When he was completely defeated by the English at Jharia he got his European prisoners shot down by his soldiery. Ramnarayan of Dacca was cast into the river. Raja Rajbulluv Punt was put to death with all his sons and after draining away the wealth of Jagat Seth he ordered him to be thrown into the Ganges from one of the bastions of the Monghyr fort. In spite of the survival of few connections here and there the house of Jagat Seth decayed until there now remains but the ruins of the beautiful Jain and Hindu temples of marble and porcelain, the old Indian Mint and the mere skull of that once magnificent dwelling of these bankers in the vicinity of Mohinpore near Murshid-

students of history. The Seths of Madura exerted much influence on the political history of South India. Historians have recorded that these bankers granted loans to rulers and financed their long protracted wars.[16] Every Native State had its banker who took an active part in the financial administration of the Princes' territories. The indigenous bankers continued to play their usual economic role in financing trade. Some of them financed the wars of the East India Company[17] and till the European Agency Houses and merchants successfully settled in the country the coastal trade of Bombay with Arabia and the South African territory was financed by the indigenous bankers of Surat.[18] Many of these old houses have disappeared and the modern indigenous banker finances the internal trade of the different provinces and plays an important part in the financial organisation of the money markets in the different cities.[19] They are the recognised money-lenders, money-changers, bullion merchants and financial middlemen.

Contact with Western civilisation.

With the advent of Western business methods the cultural superiority of the indigenous bankers began to decline. New institutions such as the Civil Courts, the Laws of Contract and Limitation and the legal practitioners soon gave scope to the indigenous bankers or the depraved money-lenders to exploit the peasants and ryots who did not know how to make a fair use of the rights of occupancy and ownership conferred on them. Money-lenders soon degenerated into landgrabbers and the pristine honesty and scrupulous regard for truth

abad—the capital of the Nawabs of Bengal. (The details are gathered from the Selections of the Calcutta Gazette, Orme's History of Hindusthan and O'Malley's History of Bengal, Bihar and Orissa.)

16 The Nagarseths of Bengal financed the local Nawabs. The Peshawas of Poona were financed by the indigenous bankers.

17 One Bansilal Abachand financed the Government of Bengal during the days of Great Sepoy Mutiny of 1857.

18 For a detailed History of the House of Arjunji Nathji of Surat see my book "Organised Banking in the Days of John Company."

19 For some past services of the Indigenous Bankers of Bombay see my paper. "Some Specific Services of the Indigenous Bankers of Bombay." Paper read before the Gwalior Session of the Historical Records Conference, 1930.

soon became dimmed by the more materialistic tendencies that have been introduced of late into the calm and placid atmosphere of our social life. Noticing this vicious change Sir R. Temple rightly remarked that "the passing of English law of bankruptcy has demoralised the native bankers of the Presidency Towns." Throughout the nineteenth century [20] and in the first two decades of the twentieth century new rival financial institutions were being created with the result that the indigenous bankers find their sphere of business restricted. They are fast losing their prominence but they are making no efforts to adapt themselves to the altered circumstances of the day. Instead of developing into modern bankers pioneering corporate financial activity they prefer to conduct "mixed" banking business in the same old traditional style.[21] Solidity and economy are no doubt prominent features of their banking business but they are lacking in adaptability and initiative which characteristics also a sound banking system should possess.

Several names.

The indigenous bankers of India are known by several names in the different parts of India. The most common names are saucar, bunniah, [22] chetty, nanavathy, nattukottai chetti, the multani,

20 See Sir R. C. Temple, Lecture before the Institute of Bankers. 1881, Vol. II (Journal of the Institute of Bankers).

21 *Vide* the Chapter "The Indigenous Banker—The C. B Enquiry Committee Report.

22 In the earlier days of the E. I. Co., the native manager of an English agency house and of a ship captain was called *Mutsaddi* by the natives and banians by the Europeans. The banian was really the factotom of houses and captains and due to the absence of any European banking establishment had the sole charge of their monetary transactions. The native agent was necessary as the goods of the Company's officers could not be sold directly to the natives on account of the ignorance of the native language on their part. High-caste Hindus refused to act as banias as the investments of the Company's officers' usually included wines, liquors and other provisions which could not be touched by the high caste Hindus. A washerman of Colootolah was entrusted with the duty of selling the investment and this dhoby gradually set up a partnership with three other friends to manage the sale business. Seeing the lucrative nature of their business legions of high-caste Hindus appeared to act as dobus to the captains of ships and the name dobus was changed to *banianship*. After the withdrawal and abolition of the company's monopoly several of the identical banians served them again as their merchants and agents. (See *the Selections from the Calcutta Gazette—Carey*—" Hon'ble the John Company.)

the arora, the rathy, mahajan, and the shroff. The well-known indigenous bankers often referred to as the mahajan, chetti, banniah or saucar have almost become an indispensable figure in our social organisation and a necessary factor in the agricultural economy of the country. His position in the financial circles of the Presidency Towns is unique and here he is referred to as the shroff.

Indigenous banking business is purely a family concern and has become a hereditary calling in particular castes and classes of society such as the Marwaris, the Jains, the Multanis, the Nattukottai Chettis and the Kallidai-Kurchi Brahmins. Almost all members of this caste or class possess fairly good business knowledge. They are remarkably astute and frugal in their habits. They have a special natural aptitude for earning and saving money. Generally no new ideas appeal to them. Their conservatism and traditional resourcefulness are undoubtedly strong assets and save them from many a bad debt. While the small money-lenders can be considered as a set of low userurs the more wealthy of these indigenous bankers are private capitalists owning magnificent sums and though they are often averse to the principles of joint-stock banking they form private partnerships under the management of the senior partner. They seldom reveal their transactions to the public and it is only when these firms occasionally fail that the general public know the real magni tude of their operations.[23] They are most courteous to their customers. They can entertain their visitors with great intimacy and much friendliness but are very reticent or maintain strict secrecy regarding their business affairs. Very often in the old days they were appointed as trustees for village endowments and the management of these lines of property tended to increase their business knowledge, pecuniary resources and social status.

But the one great defect of the private banking business of the indigenous banker is that it is usually hereditary in the family. A

[23] The failure of Sobharam Paul and Cosinath Paul, a house of 20 years' standing regarded to be the oldest shroffs in Calcutta, took place in 1838. " Their transactions often amounted to several lakhs of Rupees but the failure was limited to about a couple of lakhs and was forced upon the acting partner Cossinath by a quarrel with his brother about their joint responsibility for loss on opium that year which the latter was supposed to have ample means of making up." See the Asiatic Journal, June, 1838.

man who originally works the private bank may be a good banker, financier and business man but it does not always follow that his son who in all likelihood and certainty inherits the business will be capable of running it. The private bank wants continuity of able talents in the family. It is difficult to find that all these factors are satisfactorily obtained in a private bank. The efficiency and driving power which are to be found in joint-stock banks are seldom visible in these private banks. The joint-stock bank is not handed down by the deceased father to his son but is always under efficient and capable management. This is one feature that is telling heavily against the indigenous bankers. The verdict of history has gone against them in England and the Western countries but our indigenous bankers show no sign of speedy extinction. The starting of the co-operative bank or credit movement is itself a grave and serious warning that they have outlived their period of usefulness. If at this time when the general banking machinery of the country is being reorganised they refuse to become serviceable in the direction of establishing a real money market in the country an attempt should be made to exclude them altogether from the national credit economy of this country. As soon as the other superiorities of joint-stock [24] banking over private banks are appreciated the present scope of the private bankers would become circumscribed and may even be superseded by them.

Function of the indigenous Rural Banker.

The indigenous banker is a dealer and broker in capital. His main business is to lend money. It is not purely a case of personal security that he likes but the indigenous banker is the most inquisitive person of all mankind and the customer has to give him his free

[24] The increased security from paid-up capital, exclusive employment of it in banking business, the support which each shareholder can personally render to the establishment, publicity in its affairs, reduced charges at which a company formed for a moderate dividend can afford to conduct business, the consistency with which it conducts its business and the liberal assistance it can offer to its customers are some of the technical superiorities of joint-stock banking over private banking.

confidence. Since some of the loans are generally for performing social functions or other unproductive purposes he takes good care to take collateral securities to balance the amount of his loan. He sometimes deducts interest beforehand and pays the outstanding balance to the customer. He takes care to collect the debts by instalments. His rate of interest is often very high ranging from Rs. 18 to 36% and he is so merciless in his exactions that he has been termed the Indian "Shylock." But there has been a marked fall in this rate of interest due to the competition of the co-operative credit societies and the increase in the economic stability and peaceful conditions of society under the British Rule. But for the worthless security of the ryots who may merely be tenants with no title to land and the difficulty of collecting the original sum loaned out which has also to be reckoned the rate of interest would have been reduced to a lower figure than at present. The financing of agriculture is largely dependent on the monsoon. As this is a seasonal occupation requiring half-time employment for the money supplied by the banker, he is forced to charge a high rate of interest when it is employed. The same is the case with the shroff who is forced to charge high rates in the bazaar during the busy season when he has to earn enough profit to enable him to repay the deposits that lie unemployed in his hands during the slack season. Undoubtedly there has been a weakening of his position and he is able to thrive only in the limited area of his business. As the co-operative societies are gathering strength and are beginning to work successfully the mahajan or the bunniah is drawn into the vortex of the society. He supplies the capital as he finds better security and no risk and the co-operation of the mahajan is to be enlisted on a wide scale because he is the only educated person knowing something about banking and if his services are enrolled in the cause of the co-operative movement it will not only result in the elimination of a dangerous competitor and rival but will bring the aid of his expert knowledge to a just cause.

Instead of these rural bankers whose functions though they may be many are not so varied as those of modern corporate banking institutions or the low set of money-lending usurers who lend money at exorbitant rates, a more sympathetic lending agency has to be created. Every one has to acknowledge that such an institution already exists in the co-operative credit society.

Comparison of the *money-lending policy of the indigenous bankers and money-lenders with the policy of the Western Joint-stock Bankers.*

At the outset the difference between the money-lender and the indigenous bankers should be understood. Money-lenders depend on their own purse. They attempt to finance consumption loans also and charge higher rates of interest than the indigenous bankers who attract deposits, charge lower rates and grant loans for productive purposes alone.

The commercial banks of other countries do not grant loans for long period and lock up their funds in unrealisable assets. They never forget that all the assets of a bank should be within the quick and easy control of the bank. But the indigenous money-lenders do not conform in their business to those principles. They lend money on every kind of security preferably land, real estate and jewellery. As most of the working capital is their own they are not afraid of any run. But the mistake lies in the fact that they have not created any tangible instrument which would enable them to pass it on to their joint-stock bankers. The lack of such an instrument precludes or disqualifies them to act as an intermediary between the primary borrower and ultimate lender, *viz.*, the joint-stock banks of the country. Any liquid paper backed by the endorsement of the indigenous banker should comply with the joint-stock banks. By this method the indigenous banker can easily become an indispensable link in the banking chain which connects the farm or the factory with the modern bank. Lack of adaptability and initiative must be the sole reasons of his short-sightedness in this respect.

Again the European banker weighs each debt by itself. Generally speaking he grants loans on sufficient collateral security placed in his hands and the indigenous money-lender balances good against bad debts. He distributes his risks among his various clients. When a higher and more tempting rate of interest is offered he willingly hazards the risks but of course he has the prudence to take some kind of security. So the necessity to write off bad debts is less urgent than in the case of the European banker and though the native banker does not lose his capital he gets it locked up in real estate or other properties. So for some time at least there is a temporary diminution of capital with which the business is run. The rural money-lenders

and the indigenous bankers do not understand that "the banker should be a livery stable keeper who must keep his horse always ready for the hire." He should realise that "banks are made to make capital circulate and not lock it up" as P. Leroy Beauliau has said.

It is often stated sarcastically that the Indian money-lender's motive in granting loans is not a laudable one. It is the small money-lender who generally trades on the misfortune of his clients pampering them with fresh loans till they are over head and ears in debt.[25] The only way to extricate oneself from the money-lenders' clutches is to bid farewell to the mortgaged property. The recently passed Money-lenders Acts are mere palliatives to the situation. The Usurious Loans Act of 1918, the Punjab Regulation of Accounts Act 1930, the Deccan Agriculturists' Relief Act of 1879 and 1907 and the Bengal Money Lender's Act of 1933, Land Alienation Acts and the Civil Procedure Code have made the position of the usurious money-lender very precarious and risky as the uniform and praiseworthy tendency of all these Acts has been to afford legal protection to borrowers. It is only leading to the adoption of new features on the part of money-lenders but it has not improved their fortunes in any way. The strengthening of their position would be a better line of useful reform for they are still an integral part of the real economy of our country. Licensing money-lenders with a view to check high rates of interest and check objectionable practices would appear to be a doubtful remedy. The education of the rural borrower is a better remedy and such educated (borrowers) should borrow from real credit agencies. Money-lenders should be made to join the co-operative societies or act as agents of organised joint-stock banks so that the "missing link" between the different money markets can be provided.

The like condemnation cannot be extended to the village banker of the better class who generally refuses to grant loans if there is not proper credit behind the borrower. The above description applies to

[25] According to a very widely accepted view the main cause of rural agricultural indebtedness is "the vicious system of credit of the mahajan." "All the improvidence, extravagance, the costly marriage feasts or funeral ceremonies and the ruinous litigation are merely due to the fact that the village userer is too willing to lend for these purposes." There is much truth in this view for "cheap and abundant credit is always a dangerous remedy." *Vide* the Indian Co-operative Studies, p. 35.

the low set of usurers who are rapidly springing up everywhere as the deceased products of a deceased society.[26] They consider that money-lending is the easiest way of adding to their capital.

The Western banker will not allow his gold or cash reserve to remain permanently higher than what he considers necessary for the purposes of his business. To do so would amount to neglecting his business and take profit in his business which could be safely secured and that is a course which the banker does not adopt. When the banker's reserve is in excess of his requirements he lowers the rate of discount, issues credit to a greater extent and sees his reserve gradually reduced to that amount below which he considers it unsafe to allow it to fall. Owing to the ebb and flow of his business there may be at times a superfluity of gold at the banks or the reserve may fall below the safety limit but the guiding principle is that the supply of gold should be fully utilised. The indigenous banker on the other hand lays much importance on the rate of interest.

Money-changing.

The name poddar was given to the banker who specialised in this line of exchanging of one kind of coin for another. In former times a number of mints used to work.[27] With the breakdown and gradual disintegration of the Moghul Empire the various Indian potentates set

[26] The Bengal Money Lenders' Act which was passed in 1933 is only a negative remedy to check the problem of rural finance. It attempts to charge 15% rate of interest as maximum figure and proposes to enforce this rate with retrospective effect from 1918. Ten per cent. is fixed as the proper figure for agricultural and rural loans where compound interest is allowed. Details of loans should be supplied to the borrower in 6 months if so desired. If any default were to arise the borrower is empowered not to pay interest. Such relief can be obtained in cases which apply to the Court for relief. The only proper remedy is to multiply credit agencies, *i.e.*, co-operative credit banks and land mortgage banks. The Kabuli money-lenders must be deported from the rural areas. The enforcing of an arbitrary maximum rate is sheer folly. The retrospective effect is mischievous and the Punjab province wisely refused to enact such a clause. It is positive in the sense that those who take to casual money-lending will be disheartened by such provisions of the act as these. They may create banking deposits or industrial investments.

[27] According to MacLeod "there were 994 kinds of gold and silver coins of different weights and firmness whose value was constantly varying." Hence "attempts to force bimetallism were a failure."—Indian Currency, p. 13.

up their mints and minted their own coins. This made the confusion worse confounded. The money-changers used the multifarious currency to their own advantage. The money-changers were the contractors in the native state for the mint. Up till the year 1793 there was an endless source of trouble and disturbance due to the multifarious native coinage. The East India Company began to mend matters but not until 1835 could a definite well-organised uniform coinage be issued in silver. Up till this time the money-changers began to ply a lucrative business but now this source of profits has dried up.

Deposits.

The joint-stock banks are more borrowers than lenders. They attract "other's money" in the shape of deposits, part of which they utilise in granting loans and overdrafts. Even while discounting bills of exchange or making investments the joint-stock banks give the right to draw on them and this takes the shape of a book credit with them. The customer exercises this right by drawing a cheque to meet his actual needs or may allow the amount to lie idle in his current account balance in order to draw on it at a later date. Thus in advanced societies where banking is fully understood and practised deposits arise in three ways: (*a*) by actual deposit of cash paid across the counter, (*b*) a bank loan makes a deposit, (*c*) the discounting of a bill of exchange or the making of an investment by the bank may lead to a deposit on the part of the bank. The loan of one bank generally becomes the deposit of another. Thus the banker succeeds in making the members of the community lend their savings either willingly or unwillingly and it is with such borrowed resources that he conducts his banking business.

The rural indigenous banker attracts very little resources in the shape of deposits. This is partly due to the fact that the banking habit has not taken hold of the people as yet. Nor do these people possess lucrative savings to be deposited elsewhere. He makes no attempt to attract deposits but he certainly keeps the resources that poor people generally entrust to him for safe custody. He pays a slightly higher rate than the current rate of interest which the savings bank or the joint-stock banks of his locality may undertake to pay.

He also stands ready to honour the cheques [28] with ready payment in case of current accounts. So far as their fixed deposits are concerned the depositors generally consider it a moral obligation not to embarrass the bankers by making a call at any inconvenient time. The custom of paying fixed deposits before timo whenever so required by the depositor might be seen in the case of the ordinary joint-stock bank.

There are some indigenous bankers who in the beginning of their career take much care to attract deposits but as soon as they build up a safe and lucrative business, they no longer care to burden themselves with the onerous duty of attracting deposits and be in a position always to pay them at call. These people consider deposits more a source of hindrance than help to them so much so that it has been asserted that some of the indigenous bankers have willed down to their successors never to take up the irksome business of attracting deposits. The Chettiyar bankers of South India receive current accounts as well as fixed deposits accounts. They pay promptly the cheques issued by the customers and they have adopted quite recently the practice of clearing cheques drawn on them. The Bank of Chettinad is given access to the clearing facilities provided by the Imperial Bank of India.

Again many of the shroffs, *i.e.*, indigenous bankers prefer to receive deposits from friends but not from businessmen. Full well do they know that money from business people is liable to sudden, frequent and untimely calls. So the indigenous banker does not make it a systematic policy on his part to advertise for deposits and attract them by paying a stipulated rate of interest agreed to at the beginning Yet it would be quite wrong to assert that he does not make use of 'other's money.'

To a very great extent the Moffusil banker depends for money on his own purse and if he is in need of money he goes to a fellow banker who lends him money at two to six per cent. rate of interest. It is only

[28] Sir R. Temple records that the Indian people evidently of his time never drew cheques on the deposits they gave to the indigenous bankers. "It is most extraordinary instance of the mutual distrust between man and man." But this tendency has now changed and some of the bigger indigenous bankers consent to keep current account and permit people to draw cheques on the same.

in the last resort that they go to the joint-stock banks for additional funds. Some of them view with hostility the rise and progress of these institutions but many of them have realised that they are a source of great help to them. Though in one sense they are rivals they confer inestimable advantages to the Muffusil indigenous bankers. They render unnecessary his keeping of a large stock of silver rupees. They facilitate his remittances from place to place. It might pay him to deposit his idle cash and obtain the banker's deposit rates of interest. They help him by discounting his hundis. The endorsement of the indigenous banker makes the hundi doubly strong and such a bill of exchange is a perfectly ideal security for the joint-stock bank to discount. Sometimes also a big line of overdraft is usually granted by the joint-stock bank which would aid him substantially in all his operations. Thus the starting of more joint-stock banks and the extension of their branches in the interior of the country and at the different agricultural centres is a source of direct benefit to him. In many places the indigenous bankers are coming forward to help the starting of new joint-stock banks and extending branches of old and tried banking institutions. Undoubtedly it is in the interests of this country, that progress in this direction should be accelerated. The Co-operative Banks afford the best solution and if this movement is encouraged on proper lines the usual credit needs can be supplied on more sympathetic lines than at present.

The Banking Habit.

The absence of the banking habit cannot be attributed to the indifference and apathy of the indigenous banker towards the deposits of the people. Nor is the want of security in the past the sole cause for the absence of the banking habit. The absence of savings banks or other institutions to store up savings, the frequent occurrence of famines and the poverty of the people must have retarded the actual growth of capital in India. The absence of a well-secured paper currency commanding the confidence of the community must also be held responsible for the absence of the banking habit. The rise of banking institutions and tolerable security arising out of the Pax

Britannica gave great stimulus to the growth of deposits in this country.[29] The following table shows the growth of deposits.—

Year	Presidency Banks.	Exchange Banks.	Joint-Stock Banks.	Total.
1887	11	4	1	16
1890	18	7	2	27
1897	12	9	6	27
1907	31	19	14	64
1917	75	53	32	161
1919	75	74	61	211
1920	86	75	74	235
1925	83	70	58	211
1930	84	68	68	220
1934	81	71	81	234

The shroffs and the rural indigenous bankers who receive deposits can be compared to the London Goldsmiths who were the real forerunners of modern banks in Bengal. These goldsmiths took care of the money deposited with them and seeing that the whole of the deposits were never called up at once began to issue notes which passed as money thus building up a machinery of credit which enlarged and extended the usefulness of the actual moneyed capital deposited with them. Such an enlightened policy the indigenous bankers have never attempted to pursue even though the Early European Banks pointed out the possibilities of such an enlightened policy. The right of

29 See the statistical tables relating to banks in India—latest issue—to have a complete idea of the total deposits; those of the co-operative banks, the P. O. Savings Bank and the holdings of the Postal cash certificates should be taken into consideration.

	1913	1923	1925	1927
Co-operative Bank deposits	*Nil*	...	8½	18¾
Savings Bank	20½	...	23¼/4	32
Post Office Cash certificates	...	4	...	40

note-issuing was never exploited by the indigenous bankers even before it was annexed by the Government in the year 1861.[30]

The issuing and discounting of Hundis by shroffs or the urban banks.

All banking transactions in India are exclusively in the hands of the trading classes especially in the interior of the country. Funds are exchanged from place to place by the well-known device of the hundi. Broadly speaking hundis[31] are mere substitutes for the inland trade bills. This accommodation is secured for financing actual commercial transactions.[32]

They can be safely compared to " the single name American Commercial Paper " which is freely discounted by the American Commercial banks.[33] Unless these hundis are freely discounted by the joint-stock banks the accommodation available for the merchants

[30] See the author's book Organised Banking in the Days of John Company, " *Early Bank Note Issue.*"

[31] The word " Hundi " is a Persian word given to it by the Mahomedans. But it has become a generic term denoting all instruments of exchange drawn in vernacular. It literally means " to collect." These hdndis generally run for an odd number of days which period was formerly 4 days at Benares, Bombay, Mirzapur and Lucknow, 61 days at Fatagar and Furrackabad, 121 days at Lahore and Multan. Some were drawn payable on the 11th and 21st day of issue, some of them were drawn as sight bills or " darshanee bills." Different sets of technical names were used for the three forms of hundis corresponding to the " vias " of the English bill of exchange. The first copy of the bill is known as " Khoka," the second of the three copies of the bill of exchange is known as " paith " and the third of the bill of exchange is known as " parpaith." The method of writing out the three copies also varies and the rate of discount is known as " Hundiyana " and varies with the state of trade and the standing of the party.

[32] Some of them are pure finance bills known as hand bills and the banks are careful in discounting always a limited amount of such bills for the shroffs. See appendix to the Report of the Babington Smith Committee.

[33] The commercial paper is used for financing domestic manufacture and trade is issued against the credit of the concerns while the bill of exchange and bank acceptance is an " adopted child " used for financing movements of raw materials and food-stuffs in foreign trade and represents specific commodities in storage or transit. See Burgess, " The Reserve Banks and the Money Market," p. 134.

is naturally confined to limited amounts. Money is advanced by the shroffs direct to merchants or a *hundi broker* and dealer and in exchange the hundis are drawn and accepted by them generally repayable within 60 or 90 days. If the bazar rate is high such hundis are freely purchased and rediscounted by the shroffs at the bank rate. But if the hundi rate of the Imperial Bank is higher than the bazar rate the rediscounting of the hundis does not take place.

The amount of hundis drawn depends on the state and amount of internal trade. Mr. G. F. Shirras states that the number of hundis are on the increase but in the interior specially at Ahmadabad, Benares and Cawnpore, they are becoming fewer due to the fact that there are available at present many cheaper and more secure means of remitting money, thus dispensing with the use of a hundi drawn for remittance purposes.[34] Formerly when railway communications were not very much developed the bankers used to earn much money from this source. But now other means of conveyance of money notably the splitting up of paper money, *i.e.*, Government notes into 2 parts [35] and sending each part separately, money orders, currency transfers and bank drafts are being used for remitting money from place to place.[36]

With the opening of the branches of the Imperial Bank of India a change has come over the situation. Even the Government does not issue a currency transfer on a place where a branch of the Imperial Bank exists. They are issued on Treasuries where the

[34] The *Javabi* Hundi remits money in this manner. The drawer goes to the indigenous banker and asks to remit money to the payee in another place whereupon the banker instructs his agents to pay money to the payee. The payee has to attend the office of the banker and give a receipt for the sum received by him. The banker can cancel his order to pay in case the drawer fails to keep his promise to the banker. This partakes more of the nature of a letter of recommendation than a regular bill of exchange.

[35] This practice has been penalised. But unfortunately the use of high denomination bank notes has been affected without leading towards an increased use of bank drafts and cheques.

[36] Local usages in respect of hundis are so numerous, uncertain and undefined that the Government of India feared to abolish them and the Select Committee of 1878 expressly introduced a saving clause in the N. I. Act recognising the full force of the local usages. "*Dhani*" hundis pass from hand to hand like bank notes. The word "*Dhani*" means owner. But still it is not interpreted as bearer so as to bring the matter within the penal provisions of the Paper Currency Act. In "Shajog" hundis the word "Shajog" means a respectable holder of the bazar. Acceptance is not necessary in the case of the hundi.

Imperial Bank has no branch at the same rates approved by the bank. When postal facilities become interrupted due to strikes on railways or of postal employees, funds may be remitted by means of transfers. But an important part is played by the indigenous banker who finances to a great extent the moving and storing of crops required for local consumption and for export purposes and these loans are repaid to a considerable extent out of money obtained from banks.

The hundi changes hands like the bill of exchange. The dishonouring of a hundi is very rare.[37] The ordinary way of writing a hundi in some parts of the country is by writing transversely across the paper. "It bears an impressed stamp and is drawn up in the vernacular "mahajani" as it is usually styled. A hundi may be drawn to raise a loan, *i.e.*, it partakes of the character of finance bill or it may be used for financing trade when it approximates to a bill of exchange. It may be used for remittance purpose and sometimes if these banks have surplus cash which they require to remit to another place a premium may be paid instead of discount deducted.

The indigenous bankers of the earlier days usually gave drafts upon any place in the world, *viz.*, Constantinople, New York and San Fransisco. These letters of credits were drawn after letters of advice were given so that they might be honoured on all occasions. Mr. R. M. Martin says that "these native bankers corresponded not only with leading shroffs in the principal cities of India but also with their confreres in Constantinople and in large cities of Asia. By this means European intelligence was before the establishment of communication by steam known among the natives in the bazaar at Calcutta long before the Government received official tidings."[38] At present we find the shroffs of the Presidency Towns accepting hundis and honouring hundis of their up-country clients who are dealers in goods and gold and silver bullion.

Rediscounting traders' bills.

The shroff acts as the middleman between the Imperial Bank and the joint-stock banks on one side and the vast trading community on

37 This has been the case since very early days and C. N. Cooke testifies warmly to the integrity and honesty of the indigenous bankers.

38 See the "Indian Empire," Vol. III, p. 559.

the other. He buys the traders' bills, *i.e.*, the hundis at a high rate of discount for ready money and when he has not enough money to carry on this business he simply rediscounts these bills or hundis at these big joint-stock banks. The Imperial Bank considers this business safe as the shroff's endorsement makes it doubly strong and as the shroff takes good care as to the nature of hundis there is no danger. He can safely be considered as the bill broker of our hundis in the money market.[39] Like the bill broker of the London Money Market he usually borrows money at very low rate in the market on "purjas," *i.e.*, demand pronotes generally repayable within a month. As the rate at which the interest is paid is 1/2 to 1% more than the deposit rate of the joint-stock banks the shroffs act as formidable competitors to banks in this respect.

The *Multani Bankers* of Bombay consider this discounting of hundis as their main line of business and they obtain handsome profits amounting to lakhs of rupees. Keen competition exists for this kind of business in the Bombay money market and profits arising out of the difference between the two rates of discount is necessarily small. But as in the L. M. Market we do not meet with a uniform rate of discount for trade bills in our local markets.

In Bombay there are two sets of the indigenous bankers, *viz.*, the Multani bankers and the Marwari bankers. The Multani bankers conduct this discounting business, lend money and confine themselves to banking business proper while the Marwari bankers transact other business. The Multani bankers purchase the hundis drawn for two or three months and they are discounted generally at 6 to 9% rate of discount. These are rediscounted at the Imperial Bank and the difference between their rediscount rate at the Imperial Bank and the rate at which they bought them constitutes the profits for them. The endorsement of the native banker is important and necessary. Hence the merchant trader has to pay this price. Unless a bill of exchange or hundi contains two supporters the Imperial Bank does not discount it.

[39] The only difference consists in the fact that the bill-brokers of the London Money Market are chiefly dependent for cash on the bank. "All that the bill-brokers'" capital consists of is a "boot and bill case" but our indigenous bankers are more independent of the bankers' help.

See Appendix to the Report of the Babington Smith Committee, p. 131.

There is an association of the Multani bankers which regulates their rate of discount in accordance with changes in the Imperial Bank rate. There were about 200-250 members in 1925 and a small committee of five members. The most senior of these bankers generally meet and regulate their discount rate.[40] They hold their meetings on every Sunday to discuss common matters pertaining to all of them. The high degree of integrity which exists among the community is a noticeable feature. It is a pity the Indian joint-stock banks do not emulate their noble example.

The bazaar rate.

No set of statistics can be collected which can show how readily and to what extent money flows from the European market to the important money centres of the country. J. M. Keynes says the "native market is ultimately dependent for its funds on the European market." According to him the rate in both the markets must move up and down in one and the same manner when money is required during the busy season. The difference between the two market rates is due to the kind of business transactions undertaken by them and the nature of security attached to this business. During the last decade of the 19th century there existed no intimate relation between the two markets.[41] Whether the conditions were quite abnormal as suggested by Keynes or whether the same facts are being repeated every year there are no official means of ascertaining.[42] There is a 'spread' between the two rates. As

[40] Even in Calcutta the Merchants' Committees and the Marwari Association makes provision for the settlement of disputes concerning hundis and the new regulations recently passed in connection with hundis payable at sight are enforced by this Association alone. See the Statesman, September 28, 1928.

[41] The Controller of Currency in his Annual Report makes a quotation of both rates in the Bombay and Calcutta money markets and a close study of the rates over a period of several years would convince one that there is not now-a-days a great difference between the Imperial Bank hundi rate and the Bombay bazaar rate where keen competitive conditions exist. During the whole of the year 1927-28 the Imperial Bank discounted hundis at the prevailing bank rate alone. If this tendency continues the old-fashioned definition of bank rate as the rate for advances on Government securities must be given up.

[42] *Vide* J. H. Sleigh's letter submitted to the Fowler Committee. This letter explains briefly the nature of the shroffs' work as regards rediscounting of hundis with the Presidency Banks. See Keynes, Indian Currency and Finance, p. 196.

competition between them becomes keen the margin would disappear. The rates would naturally reflect the nature of different risks undertaken by them. The native shroff rarely discounts foreign trade bills.[43] He generally confines his attention to hundis of Indian merchants and traders. As he knows full well their commercial standing he undertakes little risk in discounting the hundis. This fact must generally account for the difference or 'spread' between the two rates. The Indian bank rates are influenced largely by the fact that they have to finance produce for export to foreign markets and for buying raw materials for the Indian industries. Shroffs' money finances internal movements of crops and money ultimately comes from the banks to repay these advances. The shroffs' rate is considerably easy as he gets also "others" money "in the shape of deposits or he borrows on 'purjas' and on account of their great financial position they can and must underquote the bank rate to find employment for their funds. In the slack season when money goes a-begging their rate is one per cent. lower than the bank rate. This is the real cause for the "spread" between the two rates. It accounts for the high rate in the indigenous money markets also. The stringency of the money market and the keen demand for money makes them seek the aid of the Imperial Bank. Such a thing cannot be allowed when the C. Bank is created to control credit. If it fails to control either the joint-stock banks' rate in the slack season or the native bazaar rate there would be really speaking no control over the credit situation. Like the joint-stock banks the indigenous banks must look upon the Central Bank as their guide, philosopher and friend. They must work in fairly close alliance with the banks and the Central Bank of the country.

A committee of the shroffs can be established in all the money centres so as to provide the first example of the discount market as distinct from banks. The banks and the shroffs must work in a spirit of partnership for such a thing would be to their common advantage and the banks with their larger deposits ought not to murmur at the anxiety of the shroffs to borrow deposits from the public by paying a higher rate of deposits.

43 They take up foreign bills also if it suits their book says W. F. Spalding, Eastern Exchange, Currency and Finance.

Other functions than banking (Non-credit functions).

The private banker and the small money-lender generally combine business with trade and shop-keeping or hold land and do commission business and very often in order to get rich quick they speculate heavily in all kinds of produce. They do mortgaging business which often involves them in litigation. The indigenous banker specially the shroff speculates in Government paper during the off-season but very rarely holds it or lends money on it. Some of the most desperate gamblers in the market of speculation are to be found among the native bankers of Western India.[44] Their hard business-like qualities are thus grossly misused and the community does not derive much benefit out of their business energy. These traders, bankers and commission agents cannot be considered as modern bankers. It is the shroff's business which consists of bill-broking business and in addition to it lending and borrowing on a large scale that can be reckoned as the nearest possible approximation to modern banking business and in the future reorganisation of the banking system he must be considered as the keystone of the banking arch. The complete fusion of the indigenous money market with European money market can only be accomplished through this invaluable nexus of shroffs. His future position can be likened to that of the bill and acceptance houses in the London money market. His main business would be the hall-marking of bills for purpose of currency and getting the same discounted or rediscounted at the hands of the joint-stock banks and the C. B. of Issue. Rediscounting can indeed be a cheaper source of financing his operations but there is no reason why he should be deprived of the privilege of attracting deposits which he is at present performing in the money market. It is stated that this is forcing him to charge a higher rate for discounting hundis in the busy season when he can find work and as he is saddled with heavier deposits attracted at a high competitive rate he is forced to pass it on to the clients in the shape of high discount rate he charges

[44] *Vide* Sir R. Temple, "Journal of the Institute of Bankers," 1883. See also Sir D. E. Wacha, Bombay Municipal Government, pp. 21-22. A beautiful description of Bombay during 1864-66 is given in these pages. See also the Sir C. Jackson Report on the failure of the Bank of Bombay in 1868.

during the days of employment. Joint-stock banks feel the pressure of this competition and it is suggested that it would be better to deprive the shroff of this privilege of attracting deposits and compensate him by giving greater rediscounting facilities. This subject will be studied in greater detail in the course of this chapter.

At Cawnpore the native bankers or the money-lenders trade in money, cotton, grain, flour, and other articles. Some of them manage the sugar and the flour mills. At Delhi the indigenous banker finances the goldsmiths and skilled workers. The bankers of the East adhere to the practices of the guild that are comparatively neglected by the great money-lenders of Europe and counts jewels among their means of trade and not as objects or curios to be kept in their safe. He makes systematic advances to the goldsmiths and sells the finished product himself. He tries to efface the maker of the goods he sells and poses as the actual producer. Thus he appears to be both a jeweller and a banker. In Bombay the Marwari bankers deal with cotton seeds and shares and do much speculation in the value of these things. The *Natukottai Chettis* of Madras who have invested their capital in Burma and who have developed the indigenous banking system of Burma finance agriculture on a large scale and promote habits of thrift and economy by the insistence of prompt repayment of both principal as well as interest. This combination of trade with banking business is becoming indispensable on the part of the rural indigenous banker of this country. Full-time utilisation of their money as well as energy would otherwise become impossible.

In several other countries also the private bankers who do not subject themselves to any official regulations pursue an elementary form of banking business in addition to other and more lucrative forms of business. But the main defect of this kind of business is that the depositors of the private banker stand to lose their money if the private banker suffers on account of his outside activities. In spite of this disadvantage attendant on private bankers' mixed banking we find

[45] There is an indigenous bankers' association which undertakes the duty of settling commercial disputes, regulates the discount rate, and settles monetary claims. This Association is the modern counterpart of what Dr. R. Mukherjee describes as guilds. The bankers' guilds existed in the past and some specimens of these guilds might still be seen in Jaipur, Multan and Marwar—the original home of the indigenous bankers.

that in almost all countries country banking is admittedly of a mixed nature.

Before their organisation is discussed it is convenient to summarise their functions under lending money or cash credit, receiving deposits, discounting bills, financing small-scale industries and agriculture and the internal trade of country. They do not finance large-scale industries nor foreign trade of the country. A few of them act as Government Treasurers and disbursing agents of Railways and the Native States.

Organisation of business

Some of the bigger indigenous bankers have their own castemen employed as agents at all the important trade centres of the interior. The agents or "Gomasthas" are oftentimes changed from centre to centre to enable them to understand the local conditions of these several places. When once the agent is made permanent he serves his employer the whole of his life-time and devotes the whole of his energy to the success of his firm. Although the pay given generally ranges from Rs. 30 to Rs. 60 a month dishonesty on the part of these officials even in the present days of economic pressure and rising standard of living is of rare occurrence. These send weekly accounts of their work to their head office and occasionally receive instructions from the head office. Their books and accounts are written in the local vernaculars of the country and they are carefully audited by the indigenous banker himself.[46] This efficient and economically conducted personal supervision goes a long way in preventing fraud on the part of the officials and it also gives a close mastery of facts and figures relative to this business. But acting independently with no sort of team-work amongst themselves they have been unable to withstand the competition of the joint-stock banks, the co-operative banks and the Exchange Banks.

Their public spirit.

Every year on the "Depavali" day the Marwari and Gujerati bankers worship their books and distribute alms to the deserving

46 The village banker who is more a lender of money than anything else keeps no accounts and the Marwari Saukars keep a memorandum book in which they keep their accounts. But there is no elaborate system of book-keeping in this case also.

people on that particular day on a most lavish scale. The Brahmins are fed with sweetmeats and other delicious dishes and given a handsome ' Dakshina ' or present on this New Year's Day for them. The new account books are placed on the same pedestal as the goddess " Lakshimi " and worshipped. Some of the indigenous bankers set aside a small moiety of their gains in a small charity box on each and every item of profitable business. In the big cities where a number of these bankers transact business these gains are pooled and their general association [47] determines the best manner in which it is to be spent. They are well aware of the old adage which says ' Charity begins at home' but are not forgetful of the saving clause that " it does not end there."

Indigenous Bankers' Association.

In all the big commercial centres of modern India where a number of these indigenous bankers transact business they form associations to protect their mutual interests, decide financial claims and arbitrate on social disputes even. Their spirit of social co-operation, their sense of mutual economic interest and the high degree of mutual trust is so great that they submit all their commercial disputes to their arbitration courts and their decisions are virtually carried out thus resulting in great organic and functional solidarity. It has also tended " towards the development of commercial law in the country on a strictly democratic and ethical basis." [48]

Is it wise to deprive the shroff of deposits ?

Mention of this suggestion has been made already. This suggestion does not seem to the writer quite in keeping with the practice

[47] Even in the matter of helping poor and deserving people one prominent member of the association heads the subscription list and passes it on to the other and each member contributes his own quota. The common realisation of their aims, their solidarity of interest, their spirit of mutual help and co-operation are all noteworthy features. The Indian joint-stock banks have no association of their own. The existence of such an association would teach them all these necessary qualities that conduce for success in their business.

[48] For a list of the buyers of bills, sseo Burgess, " The Reserve Bank and the Money Market," pp. 139-41.

prevailing elsewhere.[49] Again it would be fraught with disastrous consequences and tend to encourage the hoarding habit on the part of the present depositors who entrust their savings to the shroffs.

The bill brokers of the L. Money Market attract funds by paying a slightly higher rate, *viz.*, 1/4 % more than what the joint-stock banks pay their depositors. This fund forms the nucleus out of which he secures the needed finances for his bill-purchasing operations. He holds the bills provided he has the wherewithal to do so. He constantly borrows money at a low rate from the banks to carry his stock-in-trade. Similarly the shroff's future business should solely consist of dealing, buying and selling bills and hundis with the help of borrowed funds in the shape of deposits. The joint-stock banks should pursue a more vigorous policy in the matter of attracting deposits, and the problem of stabilising the rate of discount all the year reducing it to a lower rate than at present can be solved by placing greater resources for discounting or rediscounting. In future when a change in the financing of domestic trade is likely to be ushered in and when increasing number of bills are to be bought the bill broker would himself possess great financial resources. For the present there are very few agencies who can buy the bank acceptances. Hence a bill market cannot be created so easily in this country as it has been done in the U.S.A. during a short span of thirteen years.

The Glass Steagall Act of 1933 withdraws the deposit privilege from the private banks of the U.S.A. until they subject themselves to Federal supervision and law. According to the suggestions of the author all private banks would either become registered banks or disappear altogether from the money market. A registered banker is subject to the control of the Reserve Bank.

Secondly, if he is forced to hold the bill or carry the assortment of bills on his shelves till the period of their maturity he is apt to be more cautious in exercising his discrimination in the matter of selecting his merchant whose bills he holds. Mere redis counting as is done by the " running " bill broker in the London Money Market would lower the standard of selection. Although he

[49] Dr. Radhakamal Mukherjee, " Democracies of the East."

stands to pay heavily for any failure of the bills he has succeeded in rediscounting still he might prefer to run the risk, for unless there is a big turnover of bills through his hands he would not be securing much profit which he can do with the greater resources he can attract in shape of deposits. Again if bills are drawn for a longer period than three months the bill broker must have ready finances to enable him to sit tight on the bill till the bill comes within the period of time for which the banker would be in a position to discount. It is not meant that the whole of the capital and deposits should be employed in the form of discounting but a considerable part of his business might be in this direction.

An elastic system of rural credit.

We have already seen how the indigenous bankers specially the rural bankers and the smaller money-lenders play a quadruple role. They are the purchasers of the rural produce and sometimes the local agents of the European mercantile firms, the village shop-keepers and money-lenders. Thus the more general practice is that the indigenous money-lenders, who are styled bankers, as soon as they attain a decent stage of opulence and wealth have brought the real sedate and painstaking bankers like the shroffs into great disrepute.

By the concentrating of too many jobs, or as the old saw says "too many irons in the fire," such as banking, agency, commission, brokerage and middlemen's profits they have failed to develop into modern bankers. Besides acting as an intermediary and accountant as the joint-stock western bankers do, the indigenous money-lenders miscalled bankers generally wish to take unfair advantage of their business habits, greed for gain, education, wealth and social position. The ignorant short-sighted extravagantly-minded and long-suffering agriculturists too often fall a prey to the crafty money-lenders. The main problem here is to reduce the high rates of interest which range from 30 to 60 % even and deprive the money-lenders or the low set of usurers of their power to squeeze the improvident, wretched and helpless borrowers. Money-lending for productive purposes by initially solvent borrowers is indispensable in the economic organisation of not *only our* but *any other* society. Timely, seasonal and regular lending of financial resources at a low rate by sympathetic agents to

needy agriculturists or industrialists is essential for their mutual prosperity. It is not by merely enacting usury laws, regulating professional money-lending by registration, fixing maximum and minimum rates of interest, passing rural insolvency acts or restricting the usufructuary mortgage of land or fixed property for a definite period alone and prohibiting the alienation of land to non-agricultural money-lenders that this deplorable situation can be met with. These negative measures cannot solve the problems. Only positive remedies such as the creation of an elastic system of rural credit and the educating of the rural borrowers are essential. In succeeding chapters the creation of an elastic system of rural credit would be discussed in detail.

Educate the rural borrowers.

But much improvement cannot be realised in rural economic organisation so long as the new banks which should displace the usurious money-lenders grant loans for unproductive purposes to the improvident borrowers. One school of opinion wishes to exonerate the Indian agriculturists from the charge of improvidence.

The advocates of this school point out that the indebtedness of the Indian peasant is generally of a cumulative character. Secondly about 50% of the money is borrowed for agricultural purposes, *i.e.*, improvement of land and purchase of live-stock. Although there is much truth in this remark still the lack of foresight and knowledge makes them incur improvident expenditure. If a scrutinising enquiry were to be made into the causes of agricultural indebtedness the following would have to be taken into consideration.[50] Wasteful social expenditure on religious ceremonies, social customs, seasonal feasts and caste dinners lead to lavish spending quite out of proportion to the actual income. Unaware of the utility of keeping family budgets these ignorant peasantry contract debt which they find it impossible to repay unless a sudden windfall happens. Even during days of prosperity the previously contracted debt is not extinguished

[50] The Glass Steagall Act of 1933 withdraws the deposit-attracting privilege from the private banks of the U. S. A. until they subject themselves to federal supervision and law. According to the author all private banks would be registered bankers or disappear altogether from our money market. A registered banker is subject to control of the R. Bank.

in full. It is generally spent on some other function with the result that the heavy load of debt is not curtailed. Banking firms preaching thrift as in France or Germany are altogether non-existent. A successive advent of natural calamities drives him into the arms of the merciless money-lenders. The lack of economic reserve or staying power forces him to sell his crop to middlemen who absorb a large portion of the consumer's payment. The absence of scientific farming, lack of subsidiary industries, the cultivation of uneconomic holdings, litigation and the lure of city pleasures are sometimes the predisposing causes which lead to agricultural indebtedness.[51] Education must open the eyes of the illiterate agriculturists as to the danger arising out of wasteful social expenditure. The growth of public opinion must help him to condemn these false standards of living. It is not mere provision of suitable credit facilities alone that can solve the problem.

Self-confidence, individual thinking, civic consiousness and adequate leadership are essential to enable them to lead a life of success, efficiency and fullness. But this realisation depends on education and proper organisation of the agricultural industry. Much can be done in this direction if rural education proceeds apace through propaganda done by the Bar Associations, the school teachers and the post-masters.

[51] A recent inquiry in the Kistna, West Godavary and East Godavary Districts, conducted by the Settlement Officer records that 37% of the delta ryots and 40% of the upland area were indebted and a classification of the reasons for the incurring of debt proves that only a small part of the debt was for unproductive purposes.

Origin of the Debts.	Percentage of Total Debts.	
	Delta.	Upland.
Purchase of new lands	28%	18%
Cultivation Expenses	24	20
Liquidation of old debts	8	24
Marriage expenses	14	7
Family "	10	9
House building	...	6
Litigation	1	2
Kist	...	...
Trad	...	...
Miscellaneous	...	...

The present position of the indigenous banker.

Thanks to the British rule a well-administered Government has given perfect security and foreign capital is being invested freely in our country. The growth of banks in this country and the recent rise of the co-operative societies have tended to restrict the field of his operations but he holds his own ground in a limited circle. A few of them are modernising their banking activities on the lines of joint-stock banks. The co-operative banks generally lend for productive purposes and the improvident man who has to borrow for social functions has been left to the mercy of the low set of usurers or money-lenders who are tarnishing the fair reputation of the indigenous bankers. The rate of interest has been drastically cut short and this is telling seriously on the rural money-lenders. The former rates of interest have been cut down to 12% or 10% in most cases. The shroffs and the urban bankers are finding it difficult to obtain the few or little deposits that they used to attract before due to the opening of new banks or branches of the existing ones. Their reluctance to finance manufacturing concerns which are rapidly springing up must also go against them. The individual proprietary basis on which private banking has hitherto been conducted must give place to banks on joint-stock basis.[52]

What India wants is not bankers of this type but banks.

Modern India requires banks whose policy should represent no interest but that of the depositor and should be directed solely to placing the bank's funds most profitably and wisely. Most of the money-lenders grant advances on short-term or long-term mortgages which cannot be considered as liquid assets. The money-lenders do not realise their responsibility to the community. The lending of capital for productive purposes is essential or else capital goes to waste. No adequate protection against an unproductive use of capital is taken by him.

[52] See my monograph on " the Future of our Agricultural Industry " published in the Welfare, May, 1926 to June, 1927. The Royal Commission on Agriculture and their Provincial Banking Enquiry Committee reports fully endorse these findings of mine.

The defect of the indigenous bankers.

The indigenous bankers, either rural or urban, have done very little to manufacture credit. The majority of their hundis can be considered as merely a species of remittance and mercantile exchange. They have never manufactured credit by the issue of notes. They have not financed manufactures on a large scale. They have failed to develop into modern bankers. It is indeed true that borrowing can be done by means of *the hundi* and some amount of credit can be created by the manufacture of usance hundis. These approximate to the type of accommodation bills and the exchange banks refuse to discount them. Besides hundi business is not prevalent in the interior.[53]

The essence of modern banking business consists in issuing credit and dealing in credit operations. The indigenous bankers have done very little as regards the development of credit beyond issuing letters of credit from one place to another. Deposit holding and the issuing of notes are alike credit operations. Both these sources of operations have been left untapped.

Finally one has to observe the list of direct and indirect services which banks perform in a modern community. Some of the most direct services performed by the commercial banks are the provision of credit or banking facilities and their extension by a network of branches. Modern banks are financial service stations. As a recent writer says, " the Western banker is a financial focus of the community. He is in constant touch with investors and can help in selling stocks and bonds. He can advise on market securities, investments,

[53] Mention should be made of the " Jokshmi Hundi " which is of the nature of the policy of insurance. This is a peculiar form of marine insurance common to native merchants. There are three parties—the drawer of the shipper of the goods, the hundiwala, *i.e.*, the underwriter and the consignee. After shipping the goods to the consignee the shippers draw a hundi and sell it to the consignee as insurer for cash which is the value of the insurance premium charged. The hundiwala sends the hundi to the agent who on safe arrival of goods goes to the consignee for payment. In case of non-acceptance or non-payment the hundiwala has to bear the loss. The only difference between the Jokshmi Hundi and the modern insurance policy is this—the money is paid to the recovered later when the goods arrive safely according to the Jokshmi Hundi.

credits and budgets and a thousand and one financial questions." [54] Our shroffs and urban bankers undoubtedly understand all these but they rarely allow outsiders to benefit by their knowledge, experience and business acumen.[55] Some of the indirect services are the providing of a sound and stable credit and currency system by enabling the financial machinery of the country to run smoothly. The indigenous banker weighed according to this standard will be found wanting. With the exception of the hundi business and the issuing of drafts on foreign centres of trade no other transactions of his benefits the community. Of course, he is the only thrifty man and the value of his example might be taken as the one other service he is giving to the community.

The indigenous banker or the shroff is not a scientific banker forbidding gross speculation and refusing to support overtrading or overinvestment. He himself violates all these functions. He fails to perform the elementary duties of a modern banker. As Dunbar has said, " to be a bank at this present day an establishment must carry on the purchase of rights to demand money in the future on securities and it must use in one form or other its own engagement for the payment of money upon demand." [56]

The important role of the Western bank er which consists in aiding production and stimulating the capabilities of the captains of industry by his timely monetary help is not a distinguishing feature of our indigenous banker. The Western banker does not create credit out of nothing but the control of capital is concentrated at the bank and the banker by means of loans and advances in one form or another and enables the persons in whom he has confidence to obtain

54 The Report of the Bengal Banking Enquiry Committee says that the hundi business is confined to Calcutta alone, p. 240.

55 *Vide* J. W. Mullalay's article on " The Banker and the Advertiser "—Bankers' Magazine, New York.

56 The Bengal Banking Enquiry Committee Report says that the indigenous bankers are fighting a losing battle. Their deposits have fallen down. Their hundi business is declining except in Calcutta. The proportion of loans they make to agriculture, industry and commerce is not known. They finance internal trade. They have no dealings with co-operative banks and loan offices. The idea that they should combine with joint-stock banks on the " commanditen " principle will not be approved as they wish to have a sole monopoly of their knowledge for themselves

the temporary use of other's money. The banker is under the strongest inducement to see that credit runs into the hands of those persons or channels from which its return will be certain. Credit finds its way to those who possess the highest credentials and offer the greatest security for the repayment of advances. The indigenous banker does not shrink from financing industries on industrial securities provided he is satisfied that the business is carried on on sound lines. But on the whole there is no fair scope and opportunity for the employment of capital on his part. As Bagehot remarks, "the Rothschilds are great capitalists but not bankers;" one must repeat the dictum that these indigenous bankers are great capitalists but not bankers.

Some of the shroffs are becoming unreliable and some of the banks extending their unsecured line of credit to those unreliable shroffs have suffered most. During the course of last half a dozen years several of these have failed on the Western side of India. The late Sir D. E. Wacha, one of the nominated Governors of the Imperial Bank, has written most disparagingly of the shroffs or *hundiwallahs* who specialise in discounting hundis.[56a] The present-day extension of unsecured credit to these people is not at all advisable under such circumstances. The only way of safeguarding the legitimate interests of the bankers is to insist on the reduction of the unsecured lines of credit to the lowest possible limit or exact collateral security. This would remedy many of the abuses. But it is impossible to prevent these shroffs acting as the financial middlemen borrowing from the banks in order to supply or lend to the needy persons at almost extortionate rates. Unless the Italian model of *Monts de Piete* or Banks of Charity for receiving legacies from which advances can be made on real estate or other articles of pawns at low rates of interest is imitated there can be no safety of these shroff's transactions and any failure of the original borrowers leads to the shroff's inability to

[56a] The indigenous bankers of Bombay consider this as a matter of grievance that the Imperial Bank or the Jt. St. Banks do not treat them as banks financing internal trade and industry of the country. Similar facilities given to banks for conducting inter-bank business should be extended to them. The Intelligence Dept. of the Imperial Bank does not make careful enquiries of their standing. Joint signatures of sureties are needed to secure banking accommodation. In short they are not being treated as banks.—See Bombay Provincial Banking Enquiry Committee, 1929-30, para. 264, p. 203, Vol. I.

pay back the funds to the banks. Some of the shroffs suffer as a result of miscalculations in their ventures of speculative activity and reverses in other directions disable them to pay back their loans to the banks. This is the real reason for the large number of bankruptcies on the Western side.

"A nation gets the banking system it deserves." It is a matter of sincere regret that in the past due to internal warfare and political turmoil there was no free scope to the growth and development of real and legitimate banking business in India on lines which the Western countries have developed.

The efficiency of a banking system depends on or should be tested by three crucial tests, *viz.*, stability, adaptability and initiative. By stability is meant firmness and security from all outside dangers. As the Right Honb'le Reginald McKenna puts it "all precaution in banking is based on the assumption that sometime or other the extraordinary may happen." [57] A banking system is perfectly secure only when a margin of provision is provided for safety in case the extraordinary were to happen.[58] When credit is rudely shaken the banking system should possess not only inherent strength but capacity to restore public confidence. This quality is the *sine qua non* of all banking business. By adaptability is understood the power to adjust itself to new conditions. When trade and industry are making progressive strides the banking system should enlarge its scope of business and undertake new functions to suit the changed environment of social and industrial life. By initiative is meant quality of creating new development.

The indigenous banking system possesses to a remarkable degree the quality of stability. The conservative lines on which the business is conducted and the close business knowledge of the several customers and the cautious way in which loans are granted conduce to stability

[57] In the previous edition numerous definitions from acknowledged authorities on banking were quoted just to show that even the shroff cannot be considered as a modern banker performing banking facilities of a varied nature. See the classical works of the authorities such as H. D. MacLeod, C. A. Conant, G. W. Gilbart, H. P. Willis, W. R. Scott, H. White and Holdsworth.

[58] His evidence before the Bradbury Committee on Municipal Savings Banks quoted from the Report, p. 42.

and so long as the indigenous banker pursues the principles laid down by his ancestors there is no danger to him. But the indigenous banking system is woefully wanting in adaptability and initiative. Only a few firms in the U. P. and the Bank of Chettinad alone have modernised their business. The remainder conduct their business on antiquated lines so much so that special facilities are denied to them by the joint-stock banks of the country.

Why has he failed to become a modern banker ?

While in Japan the merchant families which conducted banking business in the days of the feudal regime soon adapted themselves to the transformed economic organisation and became the heads of modern banks, no such forward and progressive movement can be noticed in this country. It is the environment that must be held responsible for the unprogressive nature of the indigenous banking system. We have seen how short-term and long-term mortgages are granted by the money-lender even for unproductive purposes. He has to respond to the call made by some of the improvident people. As his self-interest gets the better hold of him he forgets his banking knowledge. So long as people do not know the art of living and cannot arrange to spread their resources in such a way as to last over the whole of the year, recourse to the money-lender is inevitable in the days of unemployment. So long as the laws help him in the realisation of the terms of the contract, however unconscionable a bargain it might be, the indigenous banker or money-lender grants the loan. Having spent the loan proceeds for unproductive purposes there are no resources available to pay back the loan. The money-lender has to nurse the client till the loan and the interest comes up to the value of the mortgaged property. Then the unfortunate process of land-grabbing culminates and the money-lender becomes installed as the rightful owner of the mortgaged property. So long as these economic conditions prevail, so long as the people do not learn the art of living and so long as they have no subsidiary industries or means of livelihood to attend to in the slack period dependence on the money-lender is inevitable and the law of demand and supply operates mercilessly in raising the rate of interest. Even the European banks cannot hope to work wonders in such an atmosphere as this. We have seen

elsewhere the real limitations that check their further expansion. So the only solution is to change the economic organisation, and the real meaning of rural reconstruction is nothing more than deliberate economic transition in a way conducive to the interests of all parties. Education as to the art of living and provision of suitable opportunity for subsidiary occupations are essential before there can be any real hope of spreading genuine banking business in the rural areas of the country.

Suggestions for improving the indigenous banking system.

Modern economic development is so rapid that to-day's aims and methods become antiquated very soon and the indigenous banking system which is still conducted on time-honoured and stereotyped lines has not so far displayed any sign of adaptability. It has been the cry in India ever since industries began to be developed on the joint-stock principle of management that more capital should be accumulated. Thus it becomes clear that the first duty of the indigenous banker should have been to mobilise the money-power of the country and provide the needed credit for industries to run in perfect order. Even now the shroffs or the indigenous bankers give deposits to mills in such places as Ahmedabad, Indore, Bombay and Calcutta for fixed periods. Lending on security of raw materials would be more preferable to that of making deposits for long-term periods.

But the indigenous bankers have never perfected any scientific means to stimulate thrift and encourage the savings habit on the part of the people by systematically attracting their deposits. Secondly they have not acted as the middlemen between the savers of capital and the entrepreneurs who have needed the capital. Theirs is purely a selfish and sordid motive, namely, that of interest. So long as a high rate of interest can be procured the indigenous banker will lend money for unproductive purposes even. In Western countries " banking accommodation stimulates production and increases consumption." In the case of the indigenous money-lenders the loans are sometimes granted for unproductive purposes and the result is destruction of capital and sheer economic waste. He should realise that a bank is a reservoir of liquid capital which can be directed here and there when it is needed for temporary and seasonal use and thence be returned to the reservoir for another mission. Credit is not an end

but a means to an end. Hence it is necessary to ensure that credit is advanced for a useful purpose.

Up till now no signs are visible that the indigenous bankers will invite deposits. This they decline to do because it involves risks and a crisis may ensue if they borrow short and lend long. This is nothing but mismanagement of funds allotted to them and any locking up of funds in unrealisable assets is not sound banking. But it is high time that they should themselves do their best in promoting the new-born industrial activity spreading over the country. Unless greater capital resources are demanded by the agriculturists which they would not do so long as fragmentation of uneconomic holdings exists, no attempt would be made to gather deposits. But once a call is made the people who know the bankers intimately would be willing to entrust them with their savings. The machinery of joint-stock banks as regards the deposits is cumbrous and little understood by the people. So they will certainly prefer the indigenous banker so familiar to them to the joint-stock banks which have to be managed by outsiders or foreigners. In case there exists no co-operative bank in a village the next best thing is to induce the village mahajan to take up this policy of attracting deposits and pay for them. No doubt this is irksome to him but such a progressive policy will ensure the success of many industries and obtain much reputation for him for facilitating our onward industrial march. Next to the co-operative banks he will be the most successful agent that can succeed in gradually weaning the people from their hoarding habit or converting their savings into ornaments.

The indigenous banker is lacking in initiative. He has not taken the lead in new lines of development nor has he opened any fresh avenues of expansion. The successful development of cottage industries with the help of machinery aiding the skilled craftsmen can be easily taken up by these monied people.[59] The village mahajan finances the agriculturist and granted there is favourable monsoon and profitable employment of capital the mahajan obtains the capital lent

[59] The Mahajan must try to make their capitalist-producers but not his own slaves as it has been the case in agriculture. He should have an interest in the economic welfare of his clients.

and during the slack season it has to lie idle in his hands as there is no demand for it. This money can be profitably utilised in encouraging local industrial talent. As the Mahajan knows fully the success or otherwise of such an attempt on his part he ought to make a sincere attempt in this direction. Such legitimate promotion of cottage industries on his part, but not blackmailing as is the case now, would not only earn him a fair return of interest on his capital all round the year but it will enable the struggling agriculturists in many instances to augment their famine-resisting capacity.

The shroffs have never attempted to standardise the form of the hundis. There is a bewildering variety of usages as to their form, execution, endorsement, negotiation, discounting and payment.[60] A unification of these different systems would be of much benefit to inland trade. This is the task that should be undertaken by the indigenous banking associations. While efforts should be made to standardise the hundi the development of trade and bank acceptances by educating the businessmen ought not to be forgotten and this would eliminate the chief danger behind the hundis. Although the bulk of the hundis is of the usual English type of bill of exchange that is used in foreign trade of India still a complete uniformity is necessary in the case of bills used for inland trade.

Neither the indigenous bankers, *i.e.*, the shroffs nor the village bankers have realised the higher duty of a bank. The primary duty of it is to earn dividends for its shareholders. The next higher duty is to help the trade and industry of the country, to stabilise the financial machinery and provide stable credit for the millions of its inhabitants. The indigenous bankers are not endowed with the necessary zeal and enthusiasm to realise this high ideal. They are careful of their own materialistic ends or aims and pursuits. Many of them are hidebound by caste or conservatism. They lack the driving force or power. They have prudence, business judgment and sense of relative proportion. They need aggressive constructiveness, enthusiasm and above all imagination. Without these there would be

60 A rough idea of the different variations in the local usages in the matter of hundis can be obtained by consulting the "Negotiable Instruments Act," by K. Bhashyam and Adiga.

no progress. They must educate the borrowers in banking principles and the need of strict punctuality in paying off their liabilities. Whatever future developments may be affected in the reorganisation of Indian banking these indigenous bankers must be used as the chief backbone of the banking system. The shroff must become an integral feature of the open market that would have to be created in the near future. The indigenous joint-stock banks should freely rediscount the hundis and internal trade bills so that the financial difficulties of the merchants would be removed to a great extent. The Reserve Bank should extend greater facilities to the joint-stock banks by freely rediscounting these bills. The creation of an open market will tend to lower and stabilise the money rates and confer the much needed stability to the resources of the commercial banks.

While the shroff and the urban bankers can easily adapt themselves to changing circumstances with a little initiative on their own part the task of reforming rural money-lenders or bankers' business is no easy one. Bankers are the creatures of their environment just like other human beings. Unless an all-round improvement is brought about the money-lender cannot play a more useful part in our society and the evil of usurious money-lending would still persist. But they must be made to start banks or aid the opening of branches of the existing banks. They must play a more important part in commercial and industrial expansion of the country than at present. For a long time to come it would be inevitable on their part to lend for long periods as there is a shortage of capital for long-term investment, a shortage which the European commercial banks cannot completely remedy. An intimate relationship ought to exist between the bankers or money-lenders and industry. These monied families must take the initiative in commercial and industrial development. Taking Japan into consideration we find the great Mitsui family owning banks, shipping lines, mines and factories. A great part of the foreign trade passes through its hands. It is not only an importer of raw cotton on a great scale but it even controls cotton plantations in the U.S.A. It forms one of the most important firms engaged in silk export trade and in the development of resources of the Japanese colonies and China. The Nippon Y. K. firm affords another laudable example. It controls banking firms, insurance companies, and trading concerns which engage in iron and steel production, in mining, ship-building,

air-craft manufacture and electrical engineering. The State has from time to time turned over the control and ownership of factories or shipyards which it entrusted to these great firms and it has aided them by granting subsidies and privileges of various kinds. It is largely through these semi-official firms that the Government is able to keep its hand on the reins of Japanese economic enterprises while they in turn are strong enough to exercise a considerable influence on official policy.[61]

Whatever might be their present-day shortcomings it must not be denied that the indigenous bankers are rendering signal service to agriculture and internal trade. It behoves them to set right and adjust their system to the new and altered economic conditions of our life. They should realise the higher aims and loftier ideals of a banking system and act up to them so that they may deserve fully the appellation of bankers which is now applied rather indiscriminately to all the big capitalists and money-lenders of our country. Some of them can develop into bill-brokers, stock-brokers, financial guarantors, acceptance merchants or act as private bankers working in agreement with the joint-stock banks on the lines of the German "Kommanditen" principle. While specialisation depends on the available scope for the particular kind of business it is difficult to make the private bankers start joint-stock banks for there is no assured scope for development of Indian joint-stock banks. The registration of money-lenders as well as indigenous bankers will enable us to know more about their business. The method of strengthening their activities depends on the available information secured through registration. Pending such detailed examination it is impossible to make cut-and-dried solutions for the said reorganisation of the activities of the indigenous bankers. Even Mr. Malcolm Darling advised the Reserve Bank to gather more detailed information concerning the activities of the indigenous bankers before they are declared fit enough to be scheduled bankers. Light and more light is needed concerning their technical role as bankers. When the Provincial Governments' memoranda are made public there would be enough data to make accurate recommendations concerning their reorganisation.

[61] See G. C. Allen, " Modern Japan and its Problems."

Other quasi-banking institutions.

The indigenous class of institutions, *viz.*, the *kutte-chitte* and the *nidhis* of Madras have been performing money-lending business since 1850.[62] In the *kutte-chitte* system a number of men unite to put some specified sums in some specified time. The whole sum is drawn in a lot and the previous winner is excluded. Thus this process is continued till all subscribers have received their lots once. The sum is repaid in easily payable monthly instalments. The law relating to the chit funds needs revision so as to prevent cheating and swindling by subscribers and by the conductors of these funds. The Government of the Native State of Travancore did well in embodying the legislation with reference to these provident funds and benefit funds in a clear and concise form. Any number of the chit funds are in operation even now in Travancore, Cochin, British Malabar, Tinnevelly and other districts of South India. The endeavour ought to be in the direction of developing chit funds into village banks encouraging the deposit habit on the part of the rural population. The linking of these with the co-operative banks or the organised money markets would prevent the uneconomical investing of the chit funds in land or jewellery.

The nidhis originated in or about the year 1850. The etymological meaning of the word *nidhi* is treasure. These are associations for mutual credit registered under the Indian Companies Act. The main object with which they were started was to facilitate savings, relieve members from old debts and grant loans for all purposes on good security. Outsiders were also given loans at a higher rate of interest. Generally there are two kinds of nidhis, *viz.*, the permanent and temporary. Although these societies were started at about the same time as the co-operative societies in Germany they have had no such brilliant career as the latter. This is partly due to the fact that frauds were committed at the early stage of their existence. Want of supervision must have had its effect. Even now there is no proper outside control

[62] Prior to 1872 the loan funds or nidhis were not registered under the Indian Companies Act and had to be wound up involving a loss of 20 lakhs. Since 1872 they were started in increasing numbers and 269 nidhis failed during the years 1872-92. In March, 1929, there were roughly 228 nidhis in the Madras Presidency. Madras, Tanjore, Madura, Coimbatore and Chengalput have a large number of them.

arising from that of an independent audit. There is no publication of balance sheets. The charging of 6 and 1/4 per cent. rate of interest while 6 and 1/4 per cent. interest is actually given to depositors has to be discontinued Remuneration of the directors has to be disallowed by an Act which ought to regulate the various *nidhis* which number about 230 and which have been doing business for the past half-century. The withholding of the limited liability privileges even after a member has ceased to have any dealings with the nidhis has made the shareholders rather nervous. The method of monthly instalments and the paying of them with clocklike regularity requires some education and thrift on the part of the shareholders and the nidhi system consequently proved unsuitable to the agricultural population. In spite of these defects these nidhis are flourishing, says the Banking Blue-book, but no statistics of their number, capital and shareholders have been collected. Sir Frederick Nicholson who made a special study of the agricultural problem of Madras in the last decade of the 19th century comments on the good features of the nidhi system thus. They are the introduction of co-operative principles and habits, the stimulation of thrift and providence, the creation of business habits and punctuality, the cheapening of credit, the insuring so long as rules are observed that the members will, if non-borrowers get back their money with interest and if borrowers they are secured from all annoyance so long as they pay their dues punctually. Business is extended by cheapening loans and not by entrapping the unwary and ignorant. Profits are to be sought by the development of cheap credit and not by squeezing the individual debtor. Small savings are cared for and petty capital retained in the neighbourhood.[63]

Their future.

It is apparent then that the nidhi is a good institution for encouraging thrift. So long as they are soundly managed they work well but owing to growth or indifference the management may fall into bad hands. The system has been perfected more or less and is not capable of any further extension by selfless public workers. Besides they are mere money-lending societies lacking the fundamental conception of a banking institution. Their utility cannot be enhanced without a

[63] Sir F. Nicholson, " Report on Agricultural Banks," Madras Loan Societies.

uniform Act governing the practices of the various kinds of nidhis by the legislature of the country. "There is no concentration of idle hoards for productive purpose," as Sir Frederick Nicholson puts it. The Co-operative Credit Societies fulfil these duties more admirably. There should be an extension of these institutions. The nidhis have already fallen to the background. The Madras Banking Enquiry Committee points out "that they have a working capital of four crores and that the nidhis lend on share-capital to 90 per cent. of the paid-up share-capital, to 90 per cent. of deposits, to 50 per cent. of the value of jewels and 80 per cent. of the value of gold ornaments, to 75 per cent. of the value of goods stored in godowns and to 90 per cent. of the value of Government paper. They lend at a low rate of 6 and 1/4 per cent. but fines are levied on overdues."

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CHAPTER XI

The Industrial Banks

Need for industrial finance—The inability of commercial banks—Specialisation elsewhere—The need for specialisation—The present situation in India—The existing banks and industries—Industrial banks for large-scale and factory-type industries—State aid to industries—The existing industrial banks—Genuine industrial banks needed—Certain precautions—Other suggestions—Government's move in the right direction.

Need for finance.

That industries need finance is a self-evident proposition. Either to increase production or to buy more raw materials or to extend the size of the factory or to increase the wages of the labourers capital is needed.[1] The entrepreneur needs capital on the strength of the industrial securities he possesses which are generally as follows :—(*a*) the land on which the factory is constructed if it is the property of the industrial concern, (*b*) the factory building in which the business of manufacturing is carried on, (*c*) the implements, tools, and machinery which are required for aiding the manual labourers in the process of manufacturing, (*d*) the portion of circulating capital which is set aside for the payment of wages of labourers and the clerical staff of the factory and some contingency funds laid down for future use and (*e*) the raw materials that have been purchased with the view of being turned into finished products. These are the properties at the disposal of the entrepreneurs and on the strength of these securities capital should be obtained for any of the abovementioned purposes, *viz.*, for block account, or current account as the technical jargon puts it. "Block capital" is meant for securing fixed assets. "Working capital" or short-term finance is required to purchase raw materials to make into finished products. Varying proportions of these amounts of block capital or working capital are needed for financing the different requirements of

[1] See D. H. Robertson, "The Control of Industry," Chapter V for further discussion of the subject.

different industries—*viz.*, major or minor, or cottage industries. The longer and more roundabout the period of production the greater is the amount of block capital needed. In such organised industries as these, namely, jute, cotton, iron, and steel, hydro-electric industry and mining, large amounts of fixed capital would be needed. As a rule fixed capital requirements should be secured by share capital or debentures floated by the modern industries. Dependence on individual deposits for securing fixed capital is also noticeable in some cases. But it is the very insecurity or instability of these funds which has created the industrial finance problem in this country. Some of the unorganised industries work on individual proprietary basis and their further industrial progress is handicapped for the lack of cheap industrial finance. Such has been the fate of rice mills, oil mills, soap factories, hosieries, etc. A glance at the different pages of the Reports of the Tariff Boards will easily reveal the financial difficulties of the industrial companies.

The inability of commercial banks.

But the ordinary banks, or commercial banks as they are styled, are not in a position to grant accommodation for the following reasons. Firstly a commercial banker is not an expert in the matter of land valuation or building valuation. The value of land might deteriorate on account of social conditions. It might land him into a course of protracted litigation if the rights were not to be securely guarded. The ordinary banker does not care to scrutinise all these carefully and grant the needed accommodation. In fact neither has he the inclination nor the time required to value carefully these securities. Again building and machinery would fall in value if the company were to cease production for a time. The machinery unless looked after will be valued as old iron and nothing more. The raw materials of the entrepreneurs might be of a nature whose value the banker might not easily estimate and so it is not possible for the entrepreneur to persuade the commercial banker to give the needed accommodation. The possibility of a labour strike, the perishable nature of the articles mentioned and the possibility of foreign competition will have to be considered. As the entrepreneur is not in a position to satisfy the commercial bankers as to the nature of securities he has to offer, the commercial banker

refuses to grant the exact amount of capital which the industrialist's securities warrant him to demand. The securities that satisfy the facilities of prudent commercial banking would possess the following features. Hence they cannot easily finance both " block " as well as " working capital " requirements of industries.

As George Rae[2] says " they should possess a well-known character and be of a definite nature. They should be readily convertible into cash. The pledger's title should be unquestionable. They should be legally pledged to the bank. They should be of sufficient value to cover the indebtedness and possibly expenses of collection and contingent charges. They should be definitely located. The pledger's character should be prudent and industrious. The securities should be of such a nature as to possess stable value. A perfect banking security should combine ultimate safety, a certainty of payment on a specified and not a distant day, a capability of being converted into money in cases of unexpected emergency and freedom from liability of depreciation." The industrial securities do not possess these characteristics. Besides this reason the commercial banker thinks that the investment of short-dated deposits in non-convertible securities is hardly consonant with the sound canons of commercial banking. Any bank that dares to undertake the three lines of financing agriculture, industry, and commerce in its hand is sure to come to grief.[3]

Specialisation.

On the European continent the State filled up the gap between commercial banks and industrial companies by starting discount houses for temporary periods and when the necessity was over they were abolished. In most of the western countries banking institutions exist for these three purposes. In France the Credit Agricole takes up agricultural finance in its hands. The Credit Foncier takes up the business of the mortgage loans and loans to communes and thus provides long-term credit. The Durand rural banks based on the Raiffeisin Co-operative principle are doing good service to agriculture.

2 *Vide* George Rae, " The Country Banker."

3 Some of the bank failures in the Province of the Punjab are an evidence of the glaring violation of this acknowledged principle.

The Banque de' Paris et Des Pays-Bas takes up the financing of such industries as railway building, harbours, tramways, electrical enterprises and frequently acts as the manager of syndicate for promoting industrial concerns. The Banque Nationale Francaise de Commerce Exterieur mainly exists for assisting French exporters. It has numerous agencies in foreign countries. It maintains an efficient intelligence service. It helps the French people in recovering their debts.

In the U. S. A. Issue Houses exist so that industrial companies can secure their services. " The American Banks lend through brokers large sums to investors against industrial securities. The loans of this kind are equal to the loans made direct by them to industry, says the Macmillan Committee. As a large number of banking companies exist the problem of securing necessary capital is easy. But there is no close connection between banks and industry as it is the case with the German credit banks.

In Germany the Raiffesin Co operative Credit Societies and the Landshaften take up the business of agricultural finance. The small producer and the artisan is looked after by the Schulze Delitzch type of co-operative societies. The Preussiche Prendrief Bank and Preussiche Central Boden Credit look after mortgage business. Municipal finance is the special field of the Stadt banks. In addition to these the Grossbanken play an important part in the financing of industries.[4]

[4] The German Grossbanken perform the following banking operations : (*a*) attracting deposits, (*b*) giving loans, (*c*) discounting bills, (*d*) capitalising industries, (*e*) floating new industrial companies, (*f*) regulating the value of the shares by buying and selling, (*g*) buying and selling securities largely on their own account. All banks are members on the Stock Exchange. As Dr. Reisser explains, " these were forced to take up all these ultra-commercial operations in order to meet the real demand of German economic devolopment." Although they adopted a helpful attitude towards German industries they were managed very well from the beginning and owing to sound precautions they undertook the credit system was not put to a severe strain. They had a high paid-up capital of their own and attracted long-term deposits. They always combined to help the financing of large-scale industries. The Deutsch Bank acquired interests in the smaller banks and thoroughly controlled their policy. The policy of the German banks interlocking themselves with industrial companies led to their mutual development. As Leopold Joseph says the German people have full confidence in the administration of banks and in the integrity of the Boards of Directors which are mostly composed of capable people. Stringent regulations are in force and it is only a serious catastrophe that can shake their confidence. Many of the big banks have large staff of industrial experts to guide their bankiug officials in their attitude towards industrial business. If our wish is to imitate their tactics it is absolutely essential that we should employ the same precautionary measures as the German banks.

The German banks secured financial supremacy in foreign countries while locking up very little capital of their own. They secured English and French money for the development of their own industries. The electrification of the Anglo-Argentine and the Buenos Ayres City Tramways by the A. E. G. and Co. of Berlin was rendered possible by the German banks securing loans from the English banks on the strength of their own investments. Similarly the Russian Commercial banks played a great role in industrialising Russia.[5]

In Japan the Yokohama Specie Bank has been established to look after the business of the foreign exchange and attend to other commercial purposes. The Hypothec Bank of Japan modelled on the Credit Foncier looks after the agricultural interests and grants loans on immovable property.[6] The Industrial Bank of Japan founded in 1890 is based on the model of the Credit Mobilier and is a financial organ for helping industries.[7] It does commercial financing business also but only to a limited extent. It undertakes to attract long-term deposits but relies to a large extent on its power to float debenture which can be floated at home or abroad to almost ten times its paid-up capital. Foreigners are allowed to subscribe to its share capital and it played an important part in introducing foreign capital into Japan. It also helps the Japanese investors to invest their capital in China. The Japanese Government encourages this policy by guaranteeing its profits on foreign investment with a limit of 100 mil. yen. The Japanese Government maintains the Deposits Bureau from which loans are granted at a low rate of interest to the Industrial Bank of Japan. Numerous public utility companies, and large-scale and small-sized industries have been financed by it. One prominent feature of its business is to help industrial companies during periods of falling prices. Besides this Industrial Bank there are two other important industrial banks. The Chosen Industrial Bank arose in

5 See my article, "The Japanese Banking System and its Lessons for India."—Journal of the Dept. of Letters, Cal. Uny., Vol. XXI.

6 See Dr. H. Hauser, "Germany's Commercial Grip on the World." See also Les Banques de Commerce Russe Empire—1st three chapters.

7 During the first eleven years of its working it borrowed about £35 net to finance Japanese State enterprise, *i.e.*, building railways in Manchuria.

8 See Herbert M. Bratter, "Japanese Banking." U. S. Department of Commerce (1931). Trade Promotion Series, No. 116, p. 131.

1918 out of the amalgamation of the local official banks and the Oriental Development Company was started in 1908 to finance enterprise in Manchuria and Korea. All the Colonial Banks receive financial assistance from the Government and from the Bank of Japan.[9] In addition to this every big Japanese firm has a bank of its own to make itself independent of the money market.

In England the British Trade Corporation was specially designed to grant longer and larger credits than existing banks for the helping of the British producers. But, as the late Walter Leaf points out, "after several years of experience it can hardly be claimed that the operations of the Corporation have been so successful as to show that there was a real need for it.[10] The Finance companies and the underwriters specialise in this task. Of late the fixed investment trusts have been increasing in number. The Board of Trade has at last thought necessary to protect the investor from faulty management on the part of these " Unit trusts " as it rechristens them. As the Bankers Securities Trust and the Bankers Industrial Development Company have failed to achieve their purpose a new organisation in which the Bank of England has a share-holding interest as in the case of the abovementioned companies has been organised in 1934. This new company, entitled Credit for Industry Ltd., has the right to issue debentures or short-term securities. It will specialise in providing capital for plant and equipment and working capital for small and medium-sized industries. Individual loans will be limited to £50,000 and will run for periods of from two to twenty or more years.

The Swedish Banking system recently created a quasi-state bank for granting long-term loans to industries. Thus everywhere there is a line of distinction drawn between the financing of agriculture, industry and commerce.[11]

The need for specialisation.

It is a well-known fact that the nature of capital varies in the three lines. " In commerce money invested is brought back

9 See G. C. Allen, "Modern Japan and its Problems," 1928, p. 166.

10 Walter Leaf, " Banking," p. 163.

11 Quoted from the N. M. Commission, Volume on Japanese Banking.

immediately by the disposal of the merchandise and so a long credit is not needed. In industry the capital becomes fixed in raw materials and is restored as soon as the raw materials are manufactured and sold. The capital invested on agriculture returns slowly by annual instalments. Regarding the certainty of redemption the capital invested in commerce is influenced only by artificial market fluctuations while agricultural pursuits are affected by natural causes uncontrollable by human energies so that to this extent the return of capital in agriculture is uncertain. As regards the renewal of capital in agricultural pursuits these, unlike the other two lines, require little, the period for which the capital becomes fixed being long unless the land purchased meets with some catastrophe. In industry an early renewal is necessary to a certain extent owing to wear and tear of plant and buildings and to the sale of the articles of manufacture. In commerce the term of fixed capital is shortest; renewal being necessitated on the sale of the goods." Thus the operations of capital are bound to vary in the three pursuits and so there should be three kinds of institutions providing the necessary capital.

The present situation in India.

India is a slow starter. She has now started in right earnest on the long road leading to industrial development and attempts are being made to introduce systematically modern forms of western industrialism. To help her on this long and costly journey capital is needed. By adopting a policy of " discriminating protection " the Government have not only indicated a change of heart but have proved that they are bent on placing India's industrial equipment on a par with that of the rest of the world. Strained political feelings are leading to a combined campaign of boycott of foreign goods and the encouragement of swadeshi goods. It is keenly felt that India must employ its own capital under Indian management or else foreign capital should be handled by Indians under their own management. That is why the recent abolition of the permanent Tariff Board has been causing grave anxiety to Indian minds. The attempt to lower certain import duties irrespective of the fact that they indirectly protect Indian industries has to be decried. Excessive concentration on rural development programme is bound to be sterile. A parallel development of

agriculture as well as industries is needed, for all other countries are pursuing decidedly nationalistic policies.

It is also an accepted fact that India need not necessarily copy the western industrial organisation in a wholesale manner, thus intensifying the existing evils of intensive industrialism and competition, such as overcrowding in cities and the slum areas round factories. Traditional and unique manufactures requiring special skill of the craftsmen can be carried on old lines and the transition to factory production need not be attempted in every industry. Machine production need not supersede hand labour in all industries. The present economic structure presents many interesting examples of different forms of industrial organisation. Small-scale organisation of the cottage industries with proper facilities for the training of the artisans and for the obtaining of the latest information as regards improvement in industrial arts is absolutely needed. The provision of capital and adoption of businesslike methods is no less important. The adoption of the factory system of large-scale production need not be insisted upon in every case. The introduction of electricity or hydro-electric power as a source of motive power to small units in industry thus enabling the craftsmen to compete with machine products requires capital and it is also dependent on the available marketing facilities. To accomplish any of these objects more capital is needed. As soon as the Provincial Governments complete their surveys of cottage industries, small factory type industries and large-scale industries as suggested by the Indian Economic Enquiry Committee,[12] the necessity arises for adequate finance and it has to be taken up by industrial banks and co-operative financing organisations. The development of the existing moribund and decadent small-scale industries by using machine power and modern appliances is another important work. The scope for starting new industries to utilise existing raw materials in the provinces must be examined and with such an accurate preliminary survey before them the industrial banks can hope to do something in remedying the present lack of finance which is an important cause for the slackness of our industrial activity. Close co-operation of the industrial banks with the co-operative sale societies for disposing off the finished

[12] See the Indian Economic Enquiry Committee Report, Vol. I, p. 27.

products would also contribute much towards the success of the industries.

Recent experience in connection with the gold exports sent out of the country and the floatation of Government loans and of company promotion has proved decidedly that capital would be forthcoming in India if only the needed facilities for mobilising capital are furnished. It is not only ordinary banks conducting commercial financing that are needed but industrial banks are necessary to help the current enterprises of every country and help the starting of new industrial concerns by underwriting their shares. Industry is now forced to pay too much for the use of the money and unless this price of money is reduced and industrial credit is organised the future of industry would be uncertain.

The existing banks and industries.

The Imperial Bank is prohibited to do this business, *i.e.*, grant loans for block capital by its bank charter. The other joint-stock banks slavishly model themselves on these lines hence the financing of industries is in a backward condition. The existing Indian joint-stock banks cannot hope to lock up their money in long-term loans to industries for providing block capital to finance fixed assets. After the banking crisis of 1913-15 banking deposits are generally made for short-terms, *i.e.*, six to twelve months. They charge unusually high rates, *i.e.*, 2% higher than bank rates even for short-dated loans to industrial concerns, though liquid assets are offered as securities. They are not equipped with the technical knowledge to value industrial security properly and lend on the same. Nor can they secure the help of technical experts to advise them in the matter of loaning. They take a very wide margin in their favour, *i.e.*, 20 to 25 per cent. and this is a great handicap to industrialists whose personal security even is not highly thought of. Their conservatism and lack of initiative makes them very shy towards industrial financing on a large scale. So Indian-managed industrial banks for the purpose of industrial financing should be started. They should rely on their capital, long-term deposits attracted for 3 to 5 years and debentures which they can float terminable at the end of 15 or 20 years up to ten times the volume of their capital.

No doubt the co-operative credit societies are doing something to alleviate the hard lot of the small producer and the artisan. But the middlemen sellers of the articles are strong and the co-operative credit societies alone are not the sole remedy. The financial requirements of the bigger and factory-type industries cannot be provided by them. Without the Registrar's sanction no loan can be made to a non-member.

Sometimes the village mahajan finances them but his rate of interest is prohibitive. He does not possess the patience and disinterestedness which are absolutely necessary in the matter of financing industries. His predatory profit-seeking instincts make him a hard task-master. It tends to make him study and anticipate the price fluctuations and a great deal of his skill is spent in this direction instead of being utilised towards the improvement of the organisation and technique of the industry. He generally finances the cottage industries on the advance system by which funds are given in the shape of raw material or cash and this loan has to be repaid by the sale of manufactured goods at specially low rates. The rate of interest generally works out at 25 to 50 % and the practical result is that the handicraftsmen and the artisans are little better than slaves. In the past some of the artisans were not allowed even to change their employers as a civil suit and arrest were held over them *in terrorem*.[13] In almost all cases the cupidity of these financiers conflicts with the economic welfare of the industrialists and the relatively weak position of the latter places them at a position of disadvantage.

The foreign capitalists and the managing agencies run by them wish to have all the loaves and the fishes to themselves. Some of the industries have been attracting short-term deposits and locking up these proceeds in their own business thus making it a " frozen asset." The depositor has no readily realisable instrument by means of which he can convert it into ready capital. The usually accepted and principal method by means of which this difficulty can be bridged is

[13] See the evidence of A. E. English, Registrar of Co-operative Societies, before the Indian Industrial Commission. See also H. Roses's description of the financing of the cottage industries in the Punjab. The Census of India, 1901, Vol. XVII, Part I, pp. 368-69. See also the " Survey of the Cottage Industries in Bengal," published by the Government of Benga in 1924.

by floating debentures thus providing industrial finance at a cheap rate and the industrialists need not apprehend a force l sale of their stock in order to pay back the sum in case of the depositor's call.

Another method which industrial companies generally resorted to was borrowing from rich individual lenders and indigenous bankers at a high rate of interest. But underwriting has not become very popular.[14] Indigenous bankers maintain deposits and the public also make deposits with cotton mills in Ahmedabad and Bombay.

One of the advantages of the oft-quoted and much abused managing agency [15] system is the securing of adequate finance for the industrial companies. These primitive and inefficient methods of industrial financing must be gradually superseded. If national industrial development is to be on a really encouraging scale the unscientific methods of industrial financing should be remedied as early as possible by the starting of industrial banks. As the Macmillan Committee points out " the function of an industrial bank is to act as financial adviser to existing industrial companies, advise in particular as to the provision of permanent capital, its amounts and types, secure the underwriting of and issuing the company's securities to the public of necessary assistance previously in arranging for the provision of temporary finance in anticipation of an issue, assist in financing long-term contracts at home or abroad or new developments of the existing companies or found companies for entirely new enterprises, act as intermediaries and financial advisers in the case of merger or in the case of negotiations with corresponding international groups and generally be free to carry out all types of financing business."

Such industrial banks are the *eventual organisations* by means of which industrial finance would necessarily be made available for large-scale, small-scale and organised factory type industries. But *in the meantime* the Provincial Governments would have to grant financial aid to deserving industries on the strength of the Directors of Industries' recommendation either by securing a loan from the commercial banks by itself acting as the guarantor for the borrowing

[14] *Vide* Sir Basil Blackett's speech on opening the Calcutta branch of the C. B. of India, July 24, 1924. It must however be remembered that the practice is not so universally adopted as it is supposed to be."

[15] See my essay on " the Indian Banking System," India Analysed, Vol. III.

industrialist or grant adequate loans as in the case of the Agriculturists' Loans Act. Other concessions as temporary exemption from taxation in the case of new undertakings in the initial stages, exemption from rent and royalties or lease of land on favourable terms would also be of material help to the industrial concern. The newly formed Advisory Board of Directors in the Provinces can give good advice to the Directors in the matter of Government help to industries. Wider extension of vocational, technical and commercial education would be another form of desirable indirect state assistance to industries. Preference in public contracts to Indian-made products can be granted provided the quality of the product is in no way inferior to the foreign one. Above all a reversal of Government policy before the industry can stand up on its own legs has to be given up. Private enterprise must not only be assured of steady aid and development, on the part of the state, but no reversal of policy or state-aided competition should be initiated as in the case of the Indian wagon industry and the coal industry.[16]

So far as the cottage industries and small-scale factory type industries are concerned it is universally acknowledged that the extension of the co-operative credit system would be the best financial solution. Where this cannot be secured immediately the granting of small loans has been recommended by the Indian Industrial Commission. The task of pioneering industries must be taken up and if this is not possible subsidies should be granted to individual pioneers in this direction. Even in a strong individualist country like Great Britain special steps are taken to develop the key industries such as the dye-stuff manufacturing industry, the flax industry and the cotton industry. The Macmillan Committee recommended closer relation between industry and the English banks and suggested the formation of a big industrial Corporation for facilitating the rationalisation movement in the different industries.[17] Even the Bank of England

16 See Sir R. N. Mukherjee's Address to the shareholders of the Indian Wagon Industry quoted by the Capital—Indian Industries and Trade Supplement, December 13, 1928.

17 See Paul Einzig, "Montagu Norman," p. 35. Nothing significant resulted out of this step. The principle involved in the formation of the Company was of course a breach with the established traditions. The English industrialists came to realise that it was sheer waste of time, railway fares and postage to apply to this company for financial help (*ibid*, p. 36).

took part in creating the Banker's Securities Management Trust and Bankers' Industrial Development Company to facilitate the possibility of long-term loans to industries. Quite recently a company known as Credit for Industry Ltd. has been organised and the Bank of England has a controlling interest in the same. Individual loans up to £ 50,000 can be made and they run for periods of 2 to 20 years or more.

State Aid to Industries.

There are some writers who consider it essential that the credit of the state should be enrolled for our schemes of long-term industrial finance. The examples of other countries granting special privileges, concessions and subsidies to national key industries can be quoted in abundance. The Spanish Royal Decree of 30th April, 1924, outlines the schemes for granting state assistance to industries.[18] Shipping is subsidised by most foreign governments and the Geneva resolution which condemns flag discrimination is not carried into execution by many. Coming to industrial financing in Switzerland subsidies are granted to the watch-making industry and these form a heavy charge on the finances of the Federal State.[19] In Hungary and Czechoslovakia the credit situation is eased to a certain extent by the banks financing themselves from loans made by the British and the American banks. In Jugoslavia a State Bank is contemplated to help the small tradesmen and handicraft industrialists. Loans are granted by the National Bank in Bulgaria to the different industrial enterprises. Japan still subsidises her largest navigation companies.[20] Thus all modern States tend to stimulate industrial development by the granting of subsidies or by the imposition of protective tariff or by loans from official banking institutions.[21]

[18] See the Balfour Report on Overseas Markets, p, 92.

[19] See Sir Alfred Mond, " Industry and Politics," p. 105, quoted from the Swiss Government Report.

[20] For an idea of the working of the Japanese Industrial Bank see my monograph on the Japanese Banking System—the Journal of the Department of Letters, Calcutta University.

[21] See S. E. Thomas, " British Banks and the Financing of Industries."

Already some of the Provincial Governments in India are granting loans to industries doing business in their provinces. But for greater developments in this direction grants under State Aid to Industries Act are essential to solve the middle class unemployment problem indirectly by allowing industries to absorb them.

The existing Industrial Banks.

The first bank to undertake this new type of banking business on a large scale was the Tata Industrial Bank. Modelled on it several banks were started and they professed industrial financing as their avowed object. Some of the following joint-stock banks have been started for conducting industrial financing.

Name of the Bank.	When registered.	Paid-up Capital.
		Rs.
The Tata Industrial Bank	11-2-1917	2,25,15,660
The Industrial Bank of Western India	1-10-1919	39,47,000
The Karnani Industrial Bank	1921	60,00,000
The Indian Industrial Bank	1920	3,26,000
The Raikut Industrial Bank	1922	2,47,000
The Simla Banking and Industrial Company	1921	3,39,000
The Laxmi Industrial Bank	1923	1,01,000
Native States.		
The Mysore Industrial Bank	24-6-1920	6,07,000
The Gundulpet Industrial Bank	4-7-1920	...
The Central Travancore Industrial Bank	13-9-1919	...
The South Malabar Industrial Bank	6-4-1920	...

Many of the industrial banks and several of the loan companies are attempting to imitate the *grossbanken* in conducting mixed

banking business. But they are totally lacking in the forceful initiative, untiring perseverance of knowledge and organising ability which are the marked characteristics of the German banks nor have they the requisite capital, scientific and general economic knowledge and experience at their back. They are little better than mere machineries for raising capital and much cannot be expected by their unco-ordinated action. Industries cannot be conducted successfully as small independent units. Hearty co-operation should exist between the industrial, financial and commercial communities. As Sir T. Holland says, " industries cannot flourish singly but in family groups, provinces do not develop singly but in federal associations. For the essential communications, for necessary raw materials, for markets and for financial aids and even for unskilled labour one province must rely on the resources of another," [22] This fact is more clearly emphasised by the Bombay Advisory Committee to the Indian Industrial Commission which says, " the establishment of a Central Industrial Bank or similar organisation with a large capital and numerous branches designed to afford financial support to industries for longer periods and on less restricted security that is within the power of practice of the existing banks is urgently needed as in the case of Japan a certain amount of Government aid and Government control are also necessary for its safe working."

Genuine Industrial Banks.

More industrial banks which are in touch with the small industrialists and which are fairly able to estimate well the prospect of a large range of factory-type industries and which possess sufficient money which can be locked up for long time, are an important desideratum for promoting the new-born industrial activity of the country. The industrial banks should possess a large amount of paid-up capital and attract deposits payable after a number of years. If additional capital is required it should be raised by means of debentures which may be repaid after a period of 15 or 20 years. The amount of capital that can be raised by this means can be locked up with impunity. The

22 See the Journal of Indian Industries and Labour, Feb., 1921.

industrial banks should have nothing to do with short-term deposits, remittances of money and the other ordinary commercial banking business. The Indian Industrial Commission recommended that these industrial banks should take up ordinary banking business. This is no doubt due to the desire to make the concerns profit-making ones, and whether such a thing should continue in the future will mainly depend on the number of industries forthcoming for help. If demand for industrial finance is keen it would be unwise for these banks to conduct a mixed banking business.[23] Thereby they would be defeating the very object and intention with which they have been started. Just as co-operative credit societies are to be granted access to the central reservoir of credit under the hands of the Central Banker so also the different industrial banks can also seek to expand their credit resources by securing accommodation on their own assets from the All-India Central Industrial Banking organisation if it were to be started at any time in the near future.

For the starting of the bigger factory-type new *key* industries the state must aid private initiative which puts down the requisite funds. It is by this means that India can be made independent of outside sources in the supply of these products. The state can pioneer a few such industries and hand them over to private enterprise after it has proved its commercial possibilities. The development of electrical power and distribution of this energy to cottage industries, municipalities, factories, mills, printing presses, workshops, etc., can be done easily in different provinces of this vast sub-continent. The development of the electro-chemical industries is another advantage. The manufactures of heavy chemicals on a profitable scale and the development of the aniline dye industry in the country can never be accomplished without state pioneering on a large scale. The development departments must pioneer the key industries and their work is not finished if they merely keep up an establishment for granting technical advice on industrial matters.[24] The native states such as Hyderabad and

23 Similar objections have to be levelled if the Imperial Bank of India were to attempt to conduct industrial financing on a large scale. *Vide* chapter on the Imperial Bank of India.

24 The other items of successful work on the part of the Industries Departments of the different Provincial Governments are carefully outlined by A. G. Clow, "The State and Industry," Chapters VII to XIV.

Mysore pursue a more benevolent policy encouraging deserving cottage or factory-type industries. An Industrial Trust Fund of one crore of rupees has been inaugurated in Hyderabad. Even the Nizam's State Railway is forced to assist new industries by favourable railway rates. The state pioneering of the bone-crushing and soap industry, granting of loans to industries, subscribing of share capital to the cement and glass industry and the lending of experts to solve technical problems of the cotton hand-loom industry are too well-known to need any detailed repetition here.

So far as the existing factory-type industries are concerned the managing agents look after the financing side of the transaction and they have wisely built up reserves in most cases so that existing industries finance themselves or pursue the policy of attracting deposits from indigenous bankers and lock them up to a certain extent in their own business.

Certain Precautions.

Barring the few industrial provinces like Bengal, Bombay, Bihar and Orissa and Assam there is not much scope for these genuine industrial banks in other areas of the country. The Tata Industrial Bank did not find enough scope for the business and the maximum industrial financing conducted by it amounted to roughly 32 lakhs. The risk of prematurity would have to be run if too many industrial banks are to be started. In the United Provinces Mr. C. Y. Chintamani, Minister in charge of Industries, appointed a committee to enquire into the problem of industrial financing and its report was to the effect that no such industrial banks were nécessary. No industrial banks would be needed if industrial companies accumulate handsome reserves and make provision for depreciation of machinery and other items of fixed capital. Their short-term requirements can easily be met by commercial banks. Commercial banks can aid industries by means of their six-months' loan on the security of promissory note of two directors who will be jointly and severally liable for the debt. The problem in India however is different. Industrial banks have to act as partners in newly created industries and make those ventures successful concerns. Like the German banks which, acting in co-operation with shipping, insurance and railway companies, looked after the sale of the finished

products and secured foreign markets for them, the genuine Indian industrial banks would have to pursue a similar programme of initiating, developing and expanding the factory-type industries of our country. Many of the existing industries like sugar, oil and glass require intensive development and capital would be needed for this purpose. It is a matter of gratification that Sir Pochkanavala Committee has recommended the starting of an Industrial Bank for the U. Provinces.

Provincial industrial banks are needed in Bengal, Bihar, Bombay, C. P., Assam and the U. P. They can be started with a large amount of share capital. Additional funds if needed can be raised by debentures. Such industrial banks should finance the requirements of industries of the province. An inter-provincial co-ordinating organisation can secure co-ordination. The author is clearly against the promotion of an All-India Industrial Bank as (1) the Federation will have no ample finance, (2) there are few all-India people studying industrial requirements of the country, and (3) the different demands from Provinces would be too heavy to be financed by a single All-India Bank. Industrial development is a provincial subject and an All-India Industrial Bank will meet with constitutional difficulties. If such nation-wide industries exist there will be the necessity for an All-India Industrial Corporation. But even this can be rendered unnecessary if the Inter-provincial Board properly co-ordinates the activities of the Provincial Industrial Banks. In matters of accessibility to foreign markets, popularity and confidence an All-India Industrial Bank would have a distinct advantage but this can be secured by one inter-provincial organisation. Each Provincial Industrial Bank can have a starting capital of Rs. 1 to 5 crores which may be augmented by floating debentures to the extent of 10 to 15 times their capital. While long-term deposits can be safely secured deposits for a shorter period than three years ought to be refused altogether in case commercial banking cannot be safely conducted along with industrial banking. So long as short-term deposits are refused short-term loans cannot be granted and existing commercial banks will not feel the stress of competition. A Government guaranteed institution either with reference to capital of shareholders or debenture-holders or interest on capital of shareholders or debenture-holders or both would make the industrial bank a popular body. The making of debentures trustee securities would easily enhance their

popularity. Under proper Government supervision and control the provincial industrial banks might be made to run on successful lines.[25] They should refuse loans to speculative concerns or overdeveloped industries. With proper sinking fund arrangement to repay the debentures the Industrial Corporation can succeed.

The Principles of Industrial Credit.

The industrial bank should not finance solely one single interest or a single group of interdependent interests because the bank's fate will be ruined in case any calamity befalls that industry. The way to help new industries is to supply initial capital after carefully examining the business proposals or provide a money loan after the industrial concern is floated in the market. It can grant loans on the industrial securities of the concerns or it can underwrite some of the Company's shares itself. But it is essential in this case that the Directors of the Bank should first of all know something of the undertaking. It would be wise if it were to employ specialists in this direction to examine the proposal and pronounce their opinion on the future prospects of the industrial undertaking and be guided according to their advice. The advice of the Industries Department can also be enrolled for the same purpose. The Industrial Bank should wisely distribute its capital, *i.e.*, loans on plant, buildings and lands should be well considered and limited in each case but it is always in its interest not to invest a large proportion of its resources in providing working capital to new concerns. The success or otherwise of the bank would depend on the limitation of each class of business to its proper proportions. But, of course, when it supplies much initial capital it should take care to protect its own interests by employing one or two of its men as directors of the new industrial concerns. Its rôle should be that of a confidential adviser. It should build up a sound reserve out of its surplus profits.

[25] The arguments for an All-India Industrial Bank are not at all valid in view of the fact that industries fall within the province of Provincial Governments, that the large resources needed cannot be secured by the All-India Government, that the economy of expert management arising out of all-India experts at the centre can be secured by borrowing these experts. In view of the fact that on the other hand an inter-provincial organisation to secure proper financing would secure proper co-ordination the Federal Legislature of the country would have to decide the formation of this body.

The task of rendering financial help to all industrial concerns lies before the industrial banks that have arisen and that are yet to arise. The Federation of Bengal Loan Societies should not only act as the financial provider to the 1,000 loan companies that would be affiliated to it. But it should be able to give expert advice and encourage qualified Indians to take up those manufacturing lines where there are possibilities of success. The Federation of the Bengal Banks ought to consider it as its duty to bring about through the Loan Companies the development of inland transport facilities by starting and financing small light railways, modernised ferry services and the motor services. The industrialisation of agriculture, the starting of engineering workshops, and tacking on of subsidiary industries to agricultural occupation as poultry farming, bee-keeping, dairy farming and cocoon rearing cannot be accomplished without long-term financial aid from industrial banks and a proper financial supervision would also enable them to meet with success. Jute mills in the different Bengal districts are essential if the emancipation of the agriculturists from the thraldom of the foreign capitalists who control the market is to be removed. An enterprising Industrial Bank or the proposed Federation of the Bengal Loan Companies can hope to control all existing insurance companies of all kinds, Fire, Life, Marine and Accident included, on similar lines as the Calcutta American Foreign Insurance Association. Some of the industrial banks might even hope to control the sale of the exports in the foreign markets by providing suitable arrangements with foreign trade associations. The exploration of foreign markets can also be accomplished by Indian Consular agents established in the foreign countries.[26]

In Great Britain the British Trade Corporation [27] undertook to organise study and research into new ideas and inventions and

[26] Consular agents and Trade Commissioners sitting as the representatives of the Government of India must explore the Foreign markets and communicate to the Indian industrialists the exact requirements. Thus they can expand the export trade of the country. It is not the cotton industrialists or manufacturers alone that can be benefited. A museum of Indian products ought to be attached to these offices and information regarding the exhibits should be made freely available to foreign consumers. Every trade must have an export-selling organisation acting in touch with the industrial banks and seek the sale of products which are not absorbed in the home market.

[27] For the actual work accomplished by the Trade Indemnity an off-shoot of the British Trade Corporation—see L. R. Robinson's "Foreign Credit Facilities in the United Kingdom."

examine and nurse new schemes of developments until sufficiently ripe for public investment. The Corporation was meant " to act as a link between the British investor and British industry." Our Industrial Banks should have this lofty ideal before them rather than be mindful of their own interest and attend to ordinary banking business, also. There is no use of merely granting loans on approved securities to the existing industries. In the absence of trusts or finance companies or underwriters they must float undoubted industrial companies underwriting their capital and offering the public ample facilities to invest their humble savings in these new undertakings so that they should not only be helping the existing industries but actually create new industries where there are possibilities of success. If Indians possessing the necessary industrial initiative and resourcefulness are not to be had they should persuade enterprising entrepreneurs of the West to go over and convert the raw materials into manufactured products rather than allow them to be shipped to foreign lands to be re-exported to India as finished products. This process will enable the Indian Industrialists to gather first-hand technical knowledge and adequate experience from the foreign manufacturers' hands. Then only can a great impulse be given to industrialism in our country.

The Provincial Industrial Banks can purchase the total output and offer the same for sale in its depots and the industrial banks would be justified in charging a slight commission for this work. The recently started U. P. Industries Reorganisation Committee echoes this self-same opinion which was voiced so long ago. They can also bring about the use of improved machines, tools and appliances by the method of hire-purchase system. Some such financial help is required in the case of several of our cottage industries if they are to be rescued from the clutches of the rapacious mahajans. Cotton-weaving, brass and bell-metal industry, the cotton industry, the *chicon* and embroidery industry, and the cutlery industry can be helped to a great extent if small industrial banks, working in co-operation with the industries department of the Provinces, are started on a large scale.

Again the industrial banks must realise that the Indian investors have no proper guide at present to direct their savings into productive channels. They lock up their savings in the Post Office Cash Certificates or invest them in unremunerative forms of employment. Such misdirection of savings and their wrong use should be checked

and the industrial banks should stimulate the promotion of new industrial undertakings and carry them to a successful conclusion. India is capable of becoming one of the foremost industrial countries of the world if only her industrial banks can supply the needed enterprise and provide effective finance and induce for some time to come the required technical experts to come out from the West and settle here. Our own capital is immobile and our business knowledge, technical skill and banking experience are limited and until there is a marked improvement in these lines co-operation with British business knowledge is absolutely necessary. Our industrial banks should work in close harmony with the existing foreign industrialists and capitalists in our country and try to create the investment habit in the minds of our people. But finance is not everything in the matter of industrial organisation and its success. Industrial leadership is no less essential.

What the Government have done so far.

The Government of India professes sympathy and has laid down as its policy the successful promotion of Indian Industries.[28] The adoption of the policy of scientifically discriminating protection and the appointment of an expert Tariff Board to examine the different applications for protection have become accepted features of its policy. This gives us indeed a new meaning to the powers of fiscal autonomy she possesses. As the present-day drift towards a policy of nation-wide excises on home manufactures would stultify the protectionist policy and retard our industrial development, it has to be forsaken as soon as a healthy financial situation is reached. The purchasing of stores in this country, the appointing of a popular minister in touch with the needs and aspirations of the Indian industrialists as the head of the industries department, the passing of acts intended to outline

[28] The abolition of the cotton excise duties, the grant of state subsidy to the Tata Iron and Steel Works, the purchase of indigenous articles and the granting of increased funds for scientific research are unmistakable proofs of its sincerity towards the cause of our industrial development.

[29] A more enlightened policy of Government purchase of stores was inaugurated in 1928. Rupee tenders and a patronising of the Indian manufactures without sacrifice of quality are its corner-stones.

the financial aid of the state to industries,[30] the formation of Advisory Industrial Boards in the various provinces to help and guide the deliberations of the Industries Department are useful steps in the right direction but the starving of the transferred departments is too well-known to need any repetition here. Without adequate funds even for the undertaking of scientific [31] research by the several industries very little could be accomplished by the State in the direction of industrial development. The Provincial Governments have not however kept quiet in this direction.[32] The starting of the Mining School, the Bengal Tanning Institute and the Calcutta Technical Institute are tangible proofs of the anxiety of the Bengal Provincial Government to improve technical and industrial education in co-ordination with Indian Industries. The local Governments have represented the case of the industries in matters such as currency and railway freights to the proper authorities. Something more has to be done in this

30 Some of the provincial governments have lent to the different industrialists substantial amounts and in most cases they have been returned promptly. In several instances there are no assets to be realised and the Government lost the money advanced. In other cases even after reducing their claims they have been unable to reclaim their loans. But this policy of substituting reduced claims of lesser stringency must be followed unanimously so as to make the policy of reconstruction possible. Such a policy is framed by the English Joint-stock banks. See the recent reconstruction of Messrs. Pearson and Knowles—Manchester Guardian Commercial—July 12, 1928 and September, 1927.

31 It must be admitted that the Meston Award is responsible for this. Thanks to Sir Basil Blackett these Provincial contributions have been wiped away. But the industrial provinces like Bengal, Bombay and the United Provinces have very little resources left to them to be utilised for the nation-building departments. More resources should be granted to them so that they may discharge their duties properly and aid the development of national welfare. Only direct taxation is left to the Provincial Governments. Indirect taxation lies solely in the hands of the Central Government and it has also two of the most important direct taxes, namely, Income Tax and Super Tax, in its hands. The Provincial contributions to the Central Government have been removed altogether but no great relief has been secured thereby for the industrial provinces have to meet ever-expanding items of expenditures with stationary resources. The Central Government should not encroach further upon the field of direct taxation. Again the transferred subjects should be given more money as soon as promising schemes of developments are hatched by the ministers. A change ought to appear in days of provincial autonomy.

32 So recently as in 1927 a resolution was moved in the Council of State urging the All-India Government to set aside 50 lakhs annually for a period of 10 years, for developing industries and carry out its duties with reference to industrial research and the All-India industrial services such as chemists and engineers.

direction. The stores purchase policy ought to favour Indian industries. It should put an end to the differential treatment of European and Indian industries by the Railway Companies.[33] India need not go through the long apprenticeship of patient trial, research and experiment by which the industries of the European countries have been built up. By engrafting on her economic system some of the features of industrialised countries India will become a tower of strength to the British Empire. Provincial Emporiums, commercial museums and propagandist bodies should exist with the sole aim of creating a taste for the created products of the manufacturers of the provinces. The subsidised Provincial Marketing Associations should exist and function on lines akin to those of the Empire Marketing Board. The services of provincial industrial experts capable of guiding the industries in

[33] The Railway Board has no doubt issued a Circular on May 18, 1918, to the Railway companies pointing out that the development of industries would increase their business and Railway administration should do much for the encouragement of industries by the quotation of favourable rates for the carriage of raw materials and of finished products. They were also asked to co-operate in making a special endeavour to do all that was possible for the encouragement of the Indian industries. But the excellent intentions of the Government get whittled down to precious little while filtering through the administrative strata of the Railway companies. Before the three committees of 1918, 1921 and 1922, namely, the Industrial Commission, the Railway Committee and the Fiscal Commission several of the witnesses spoke disparagingly of the Railway rates policy. The Railway Rates Advisory Committee should be converted into that of the Railway Rates Tribunal as in the case of the American Inter-State Commerce Commission. Above all a re-arrangement of the railway rates on a sounder foundation is the immediate necessity. The introduction of a thorough telescope system for goods traffic over various railways as is prevailing in America is essential. Even the British Railways adopted this in 1921. These exist here only in the case of local traffic. Instead of forming the heavy reserves, the reduction of rates and fares should continue.

The standardisation of railway revenue so as to secure the fixed contribution to the general revenue, the guaranteed interest, depreciation and other capital liabilities, is also essential. The developing of railways in new areas and extending the technical improvements have also to be considered as equally important. The adoption of a unanimous rates schedule is long overdue and without such impetus it is difficult for this country to secure industrial progress. The recommendations of the Wedgewood Committee ought to be carried out.

Similarly there is no use of merely reserving the coastal traffic to the Indian shipping companies alone. Reduction of shipping freights is essential to enable the Indian industrialists to enter the foreign markets and compete successfully with other foreign merchants or domestic producers of the foreign countries. The Meek Commission has failed to analyse how the shipping charge as an item of cost to be borne by the Indian industrialist has been handicapping him in competition with Japanese products in markets of the Near East and Africa.

their different branches ought to be placed at the disposal of the industries by the Provincial Government. Commercial and financial intelligence should be supplied gratis. A combined system of commercial knowledge with vocational or technical education has to be approved in place of pure technical schools. Travelling teachers might carry on further instructional propaganda and be of particular use in demonstrating improved measures of production. The Provinces of Madras, Bengal and Bombay ought to pursue such an industrial policy as outlined above.

So long as the period of falling prices and heavy depression is continuing it is advisable that the State should delay the formation of industrial corporations. Nothing is more important than that a definite industrial policy should be developed, for without such a helpful attitude the dumping of products by a foreign firm would easily destroy the locally manufactured ones. *More* finance, *better* finance, a definite industrial policy, capable industrial leaders, highly qualified technical experts, the development of entrepreneur spirit on the part of the people, organised enterprises and an organic relation between industry and the State are the *sine qua non* for the growth of Indian industrial enterprises under Indian control commensurate with the available resources, labour supply, great variety of the climate, and abundantly rich and diversified raw materials of the country.

Nothing is more important than the shattering of the foreign expert's opinion which says that " the state should have nothing to do with industrial initiative and enterprise." The foreign experts have evidently forgotten how the post-war economic recovery of Germany has been secured as a result of State and municipal activity. In public enterprises so vital for economic welfare the State has formed joint-stock companies and has managed the industrial activity on pure business basis. About one-fifth of the entire economic activity of German life is in the hands of the various Governments. The selfsame lesson of governmental industrial activity can be grasped from a study of the Italian industry. The " Institute Mobiliare Italiano " has been recently started for making loans for a period not exceeding ten years to Italian enterprises of a private character and the acquiring of shares in such undertakings. It is meant to solve the twin problems of industrial finance and banking stability at the same time.

Unless India determines which type of social and political philosophy she cares to adopt nothing definite as regards the attitude of the Indian State towards organised industrial activity can be foreshadowed. Unfortunately under the new constitution of 1935 economic improvement is left to be achieved by private initiative alone. A continuance of *laissez faire* traditions means the free play of the forces of private capitalism. If the paternalistic State socialism which is the order of the day in all civilised countries is to be advocated, and if the preconceived belief that on the average Government enterprise is less efficient, less progressive and more costly than private enterprise is forgotten, the Indian people would have to decide what useful part the State has to play in the industrial and economic life of the people. Every natural industrial monopoly and large public utilities such as electric power resources have to be worked under State ownership and control. The holding company (Germany has developed the holding company known as V I A G. or to give it its full name it is known as the Vereinigte-Industri-unternnungen Aktiengesselschaft. It is a company with a capital of 120 mil. marks. Its enterprises include, besides the bank, the accounting firm, electricity, gas, aluminium, nitrate, iron and machinery enterprises and a steamship company. Better form of business organisation and industrial leadership will be needed for our success in this direction; or the managing trust form of enterprise so well-known in the German industrial field would have to be built up.

A note on the German Industrial Bank.

The recently started German Industrial Bank should not be mistaken for a bank founding new industries or financing the existing German industries. It was created to act as an intermediary for the German industrial enterprises and pay to the Reichsbank to the credit of the Agent General for the account of the Trustee. The local redemption debt of 5 million gold marks has to be paid by the German industrial enterprises and each industrial enterprise has to float the bonds or its debentures and deliver them to the bank. Each debenture is payable in gold marks and is issued in favour of the German Industrial Bank. Against these debentures the Industrial Bank issues 5% industrial bonds payable to bearer in two series of 2½ milliard gold marks each.

The German Industrial Bank has a capital of 10,000,000 gold marks with its head office in Berlin. The managing board is of German nationality and the Board of Directors is composed of 15 members. On February 28, 1925, the industrial bonds were issued and there are about 605,000 assessed industrial enterprises responsible for the payment of the reparation debt. (See Bergmann, " Reparations Payment.")

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CHAPTER XII

Mortgage Banks and Agricultural Credit.

Era of specialisation—Specialisation in the case of other banking systems—Necessity of mortgage banks—Legislation is no cure for the situation—The money-lender must become a modern banker—Urban mortgage banks—The essential factors of credit—The function of credit in agriculture—Analysis of credit needs—Existing credit facilities in this country—Facilities in other countries—The example of Germany—The example of France—The example of the U.S.A.—The example of other countries.

Mortgage banks and agricultural credit.

The twentieth century is a century of specialisation. This tendency towards specialisation is visible in banking business as in all other walks of our business life. The English banking system exhibits the specialising tendency to a very marked degree. The ordinary commercial banks or "cheque-paying banks" take up the business of attracting deposits and distribute their capital in loans, overdrafts and discounts. They make every effort to meet the short-term credit requirements of commerce, small agriculture and industry.[1] The discount

[1] It is often stated in the United Kingdom that the commercial banks do not treat agriculture sympathetically as they do the urban interests. The disappearance of the old country banks and the extension of branches of big joint-stock banks whose policy is guided by the London Board and the draining away of the rural deposits to urban areas for commercial and speculative purposes at home and abroad are considered as leading to the unsympathetic treatment of agricultural interests. The banks refute the charges of unsympathetic policy, unfamiliar managers and discrimination in favour of commercial investment and point out that more agricultural loans are outstanding to-day than in the case of small local and private banks. They point out that there is keen competition among the joint-stock banks to develop the agricultural connection. Overdrafts unspecified as regards purposes are frequently granted in preference to loan accounts. The old bank managers are still in office to help the new managers in the matter of studying local characteristics of business. Both in England and Scotland the banks have largely invested in loaning to agriculturists to meet their short-term needs. The sureties are conjointly and severally liable and are bound to the extent of the *principal plus three years' interest.* The rate of interest charged appears to be five per cent." *Vide* the Report of the Chambers Committee on Agricultural Credit. See also Walter Leaf's Address, Annual General Meeting of the Westminster Bank," February, 1923.

business is specialised by bill-brokers, and the big discount houses who run a much bigger book than the individual or "running" brokers. The acceptance business is looked after by certain merchant houses though to a certain extent the commercial banks are becoming the 'watch dogs' over the volume of acceptance. The British Trade Corporation[2] was started in order to grant longer credits to industries and trade and any com petition with the existing commercial banks is altogether eschewed b y certain rules in its charter. Besides these bodies there are other schemes of industrial and mercantile banks in London with regional banks for promoting fo reign trade and industry,[3] international credit and discounting institutions .[4] Mortgage loans can be secured through such well-known channels as private investors lending through solicitors and insurance companies. In England the Investment Trusts and Finance Companies conduct loaning business on mortgage of lands, houses or shop property. The Yorkshire Penny Bank and the Birmingham Municipal Bank specialise in attracting deposits of the poorer classes. Specialisation has extended so far that certain types of customers have developed the habit of conducting their business exclusively with one bank alone.[5] Both long-term and short-term credit requirements of English industry and trade are now provided to a certain extent by special financial schemes devised by the British Parliament since the war. Though these were solely organised during the critical post-war years of financial and economic instability and unemployment they are still continued and extended for short periods in view of wide-spread unemployment existing in the country.

[2] The British Trade Corporation has proved a failure and the expected advantages were not realised to any large extent. It has become a part of the Anglo-International Bank.

[3] Among these the most important are the British Overseas Bank and the British Bank for Foreign trade.

[4] The Lancashire Banks are closely identified with the cotton industry. The most important of the Lancashire banks are (1) the William Deacon Bank, (2) the Lancashire and Yorkshire Bank, (3) the District Bank, (4) the Manchester and Country Bank and (5) the Liverpool and Martin.

[5] An account with the Bank of England is considered as a commercial Coat of Arms. Messrs. Coutts and Company was considered as a bank of fashionable society. It was recently amalgamated with the National Provincial and Union Bank. Cox and Company was regarded as the military bankers. It was recently amalgamated with Llyods Bank.

Details concerning the working of the Trade Facilities Act [6] or the Export Credit Schemes [7] are surely out of place in a book on banking but the fact that the state had to take action which includes financial measures to promote trade and industries must be referred to at the outset when new industries are started in a country and it need not be stated that they should not be unduly prolonged. When private enterprise is incapable of providing sound long-term credits the need for exceptional state action has to be recognised.

Specialisation in other systems.

The same specialising tendency is visible in the Japanese banking. There are five different types of bankers which deal with home trade, foreign trade, industrial business, agricultural business and colonisation business. Besides these there are a large number of savings banks, ordinary commercial banks and a large number of co-operative societies transacting business.

It is only in the country of Germany that the Gross-banken perform a " mixed " kind of banking business. These German credit

[6] The Trade Facilities Act was first passed in 1921. The Treasury and a small Advisory Committee of experts guaranteed the payment of interest, principal or both if the proceeds of the case were to be applied for capital undertaking and would promote employment in the United Kingdom. The loans are in practice made by the Insurance companies or banks and the applicants are either public bodies or citizens of the Empire as the case may be. This Act was extended to March, 1927, and about 75 mil. worth of guarantee were given by the state. Iron and steel, engineering, the ship-building, the building and the electrical industries were the chief industries that were promoted by this Act. The present Chancellor of the Exchequer is of opinion that the Act has exhausted its usefulness and it is not likely that it would be extended further.

[7] The object of the Export Credit scheme is very wide for it aims not only at solving the unemployment problem in the United Kingdom but aims at the economic restoration of other countries. The Overseas Trade Act was passed in 1920 empowering the Board of Trade to make advances up to a certain amount on goods wholly and partly manufactured in the United Kingdom. The method of guaranteeing the bills of exchange drawn by traders, in respect of export to countries including those of the British Empire has been allowed and in 1925 barring Persia all other countries were included in this scheme. Machinery and goods requiring long-term credits are financed by this method. The Credit Insurance Committee recognised the necessity of continuing this guarantee system and under the Trade Facilities Act of 1926 the period of guarantee was extended to September, 1929, and would remain in force till September, 1933. Exports wholly or partly manufactured in the United Kingdom including coal can be financed by this method.

banks are, as Lord Inchcape styles them, "the clearing banks, acceptance houses, issuing houses, discounting companies, promoting syndicates or exchange bankers, traders and bankers." As the *Economist* puts it "the German banks are stock, bill and exchange dealers and brokers, bankers, merchants, trusts, financial and promoting companies.[8] Dr. Reisser has taken much pains to show that this has been due to historical conditions and that these "credit banks" were called upon to help the process of industrialisation. But even in the pre-war days German banking illustrated clearly the extreme tendency of specialisation. The different banking institutions can be roughly classified under the following heads, the note-issuing banks of which the Reichsbank is the most prominent one, the credit banks known as the grossbanken, private banking houses, twelve Overseas Banks, thirty-eight mortgage banks, communal, urban, district and rural mortgage associations, agricultural credit banks, three thousand one hundred and thirteen savings banks, District Municipal Associations and Artisans' and Farmers' Co-operative Loan Banks. At present however the banking system is socialised and is made to work under the supervision of a Board of Control.

Our Banking System.

Although the system of Indian banking conducted on Western lines is still in its infancy it exhibits some signs of specialisation. The Imperial Bank and the Indian joint-stock banks finance the internal trade ; the Exchange Banks deal with foreign trade and its finance. The Co-operative Societies and the P. O. Savings Banks try to encourage thrift among the poorer classes. A few industrial banks have arisen recently to finance industries but they are doing ordinary banking business. They unite deposit banking with different other operations. The task of keeping assets of a sufficiently liquid character in order to balance the demand obligations of a commercial bank is no slight one specially when operations partaking of a permanent character such as industrial finance are attempted. Many an

[8] See *the Economist*, October 21, 1911.

authority has written deprecatingly of this tendency and points out that it only paves the way to a commercial crisis.[9]

Instead of combining such risky operations in the hands of a single bank, however pressing the necessity of a liberal financial assistance to our industries and agriculture might be, it would be better business if banks were to specialise in long-term loaning. If separate financial agencies are created our banks need not, like the German banks, be nick-named " Alerlei enterprisen " and maids of all work or a kind of financial universal providers. However much our banks may be animated with a desire to emulate the bold and daring yet fruitful policy of German banks they should realise that the amount of their paid-up capital, the low proportion of their cash reserves and liquid assets, the short-term nature of their deposits and the absence of masterly financiers are real limitations warning them of the dangers involved in their ambitious programme to obtain absolute control over foreign trade, commerce and industries of our country.

Mortgage Banks.

The long-term credit requirements of either industry or agriculture have not been studied carefully. The mortgage banks of the joint-stock type or co-operative mortgage associations do not exist in this country. Sir James Meston—an ex-Finance Member of India—divided the banking system into four departments. There is first general banking, secondly land mortgage banks, thirdly the co-operative banks and fourthly the industrial banks. Specimens of the first, third and fourth type exist in our country. But the second, namely the land mortgage banks, have only very recently been started in Madras, Bengal and Bombay but they have not been popular institutions as

9 W. R. Scott says there is an over-expansion of credit caused by the exchange of investment securities for cheque accounts and that a forced liquidation of these securities to meet the depositor's call would entail a great loss and enforced liquidation may bring about a commercial crisis. H. M. Geiger says, " that the practice of commercial banking concern to invest their sums has been one of the causes of the industrial failures in the U.S.A of several enterprising men who have seen their plans shrivel and disappear under the sheriff's hammer to satisfy a note that has been called." C. A. Conant in his Modern Bank of Issue points out that the Bank of Italy, the Bank of Naples, the Bank of Sicily and the Roman Bank locked up in investments all their notes and failed in 1892.

et. Mortgage banks are included under the heading of Indian joint-tock banks and some of them, like the Allahabad Bank, Limited, and 1e Loan Companies of Bengal, lend on equitable mortgage but there s not much of specialisation of this business done by them.

The chief reason why the mortgage banks should be started is he fact that in the interior this business lies in the hands of the ıdigenous bankers and members of the wealthy class. Their terms re too high and exacting. The borrower is foolish and is exploited ccording to the urgency of his needs and nowhere does he get fair ərms to which he is entitled by virtue of his security. Organised redit should be substituted in place of these acute and shrewd money-ənders. As Sir F. Nicholson said long ago, " the individual system f providing credit is too elementary and needs must make way to igher and more organised form of credit as general wealth, order, usiness confidence and habits of association develop on the part of 1e people." These alone can eliminate the danger of usury. No mount of tinkering with laws can stop it.[9a] There is at present a nove to give some protection to the borrower and the 1926 amend-1ent have provided facilities for redemption of the mortgages. In pite of this stringent measure against usury the present system of rofessional money-lending is productive of bankruptcy, extortion from 1e borrower's property and other injuries to the rural community.[10] ther classes also generally lend money at high rates. Greater powers hould be given to the Law Court to get behind any contract with a 1oney-lender and after proper enquiry order a justifiable rate of 1terest only in such cases where the loan is unsecured and granted n personal security alone. The present system of lending does not ake into account the financial standing of the borrower and in most ases it is a harsh and unconscionable bargain. The professional 1oney-lenders must get themselves registered and the charge of com-ound interest declared illegal. Any rate above 20 % is far excessive.

9a Recent debt legislation has been aiming at the retrospective application of the ımdupat rule, the wise definition of the ridiculously low figures fixed as maximum rates of terest and the vexatious powers of intervention given to judicial and executive authorities. əneral social and economic reform is needed to improve the standard of well-being of the ots all over the country.

10 See the Report of the Royal Commission on Agriculture, paras. 430 and 440.

This rate must be sanctioned by the Registrar. One great and incidental advantage of such procedure would be the opportunity to levy a six per cent. tax or income tax on the money-lender who now escapes taxation altogether. Another piece of legislation intended to check the land-grabbing tendencies of the non-agriculturist money-lender was to restrict the alienation of land and to see that the mortgages of land are to be limited for a definite period and the land has to be surrendered by the money-lender free of all encumbrances at the end of this definite period.[11] The Royal Commission on Agriculture has wisely insisted on the universal application of such a law in the matter of usufructuary mortgage of land and its being limited to a period of twenty years.[12]

Legislation is no cure of the situation.

It does not mean that even legislation can cure all the evils of money-lending but well-considered efforts are needed to mitigate the existing evils. These measures would doubtless have popular approval and support. Like the American bankers who in order to evade Usury Laws charge the maximum seven per cent. interest and add " commission " fees " and bonus " and the like to obtain a high return for their money,[13] so also our bankers and the money-lenders can evade the usury laws in several ways. The old Agency Houses of this country similarly evaded the interest laws of this country and exacted roughly 20 to 24 % rate of interest from the indigo planters. As the bulk of the agricultural indebtedness is settled out of the Civil Court and the borrowers seldom take advantage of the law of limitation, much relief cannot be secured by legislative measures limiting the rate of interest. Hence it is not likely that the interest laws of the Government would be widely appreciated by the agriculturists. Finally, a vigorous carrying out of the usury laws would restrict some of the existing avenues to the agriculturists for obtaining the needed credit.

11 It is indeed difficult to secure this and the defeat of the Punjab Money-lenders' Bill in the Legislative Council was solely due to this difficulty.

12 See p. 419, para. 353.

13 See Ivan Wright, " Bank Credit and Agriculture," p. 238.

Money-lenders must become banks.

Our efforts should therefore be concentrated in the following direction. Firstly, the co-operation of the rural money-lenders must be enlisted. They should be made to lend to the short-term co-operative societies, co-operative mortgage societies alone or act as guarantors to the land mortgage banks. The Government need not guarantee the payment of interest on their capital. On loans he makes he can secure seven to eight per cent. rate of interest. He would secure interest on deposits forthcoming which might be reckoned at three to four times his own capital and if the method of securing loans is made easier for him than at present he would willingly join the Co-operative Credit movement or become a pure banker devoid of the interest and necessity to exploit the borrower. These co-operative societies or land mortgage banks must also arrange to dispose of the produce created to consumer's co-operative societies and secure the rural necessities through their co-operative purchasing agencies.[14] Those village land mortgage banks might buy shares in the provincial mortgage banks. Regular banking must thus be provided in the moffusil areas under the aegis of the land mortgage banks and co-operative credit societies. These should collaborate with the other agricultural non-credit co-operative societies.

Secondly, the state can do something in this direction. It can confer honorary recognition on the money-lending and the indigenous bankers who undertake to co-operate and work these land mortgage banks, stimulate the banking habit and spread genuine banking business among the urban and rural areas. The state generally confers a certificate of merit on the President of Village Unions for their good work in connection with the Union Board's work. As the sociologists remind us "What is honoured is cultivated." The monetary motive alone does not explain the human urge. In China the native government has recently inaugurated the policy of granting medals to all those women who invest in industries or industrial banks and forsake the habit of adorning themselves. Such ladies are to be decorated

14 See special Resolution II on Agricultural Co-operation by the World Economic Conference.

with phoenix medals (Wen Fang Chang). The first class medal is to be awarded for the investing of not less than $200,000 to 1,000,000; the second class to those who invest smaller amounts themselves or raise 5,000,000 or more. So medals are awarded to women for investing in industries. Some such methods have to be pursued by the Indian Government and it can be confidently stated that several of the indigenous bankers would undertake regular banking business. Public approbation would act as a sufficiently strong incentive for greater activity in this helpful line. It is high time that India should inaugurate a Board of National Investment and the Seva Samitis can undertake to work in co-operation with it. The employers and the Banks can also undertake to encourage this movement. It would have a powerful influence in securing the needed funds for our agricultural industry. *Cheap yet not facile credit* would shape the lives of the rural as well as the urban masses in a healthy way.

Urban Mortgage Banks.

The object of these urban mortgage banks should be the redemption of ancient and oppressive private mortgage by the granting of long-term loans at moderate rates of interest. When a number of such institutions transact business in the urban areas the rate of interest will be reduced and it will break the monopoly of the usurers. Their business is to grant mortgage credit without requiring any declaration of the object or purpose of the loan These should resemble the small joint-stock banks of Switzerland. A big mortgage bank situated in a populous city may find enough employment for its working capital and it may not condescend to transact business in rural and other urban centres. Urgent help is needed in rural parts also and city capital should necessarily be shifted to these parts. The union of city and urban economic forces with those of villagers is absolutely necessary.

It is sheer folly to consider mortgage business as the road leading to ruin. This is not true in every case. Sometimes it might so happen that a man's capital gets locked up in land, houses and stock. If it has to be temporarily mobilised for an occasion, raising credit by mortgaging the property should not be objected to nor should mortgage at such a time be considered a sign of weakness. But if this

borrowing is not temporary mobilising of capital but is chiefly due to improvidence and recklessness it is to be condemned as necessarily leading to ruin. But so long as a fair and equitable proportion is maintained between the liability and the assets and the rate of interest is not too high to be covered by the rate of return out of the use of the borrowed money, mortgage builds a fortune for the borrower and there is no reason to repent for the transaction. In all advanced countries including Denmark the land is mortgaged and credit is obtained for productive purposes. There is no stigma attached to any of these borrowers in any of these countries for this kind of credit secured on the mortgage of their property.

The mortgage banks should be welcomed for their competing capacity with the money-lenders. As Sir F. Nicholson emphasised long ago "competition is the only way of bridling the money-lender." He must be of no account in the general credit system of the country.[15] The competition of these banks would knock down the present high rates of interest. But it must be remembered that it is not the urban people who are the chief sufferers on account of the absence of these mortgage banks. They are no less essential for the agriculturists.

Agricultural Credit.

Economists have analysed credit into two factors namely confidence and time. Credit means the repayment of ready money to a solvent individual in the expectation that it would be returned in the future along with interest which is only a compensation to the owner for foregoing the use of capital. Credit thus benefits both the holder of capital and its borrower. Hence credit could easily become the corner-stone of the industrial, commercial and speculative aspects of

[15] Sir Daniel Hamilton says, " the interest rates of 30-60% due to the indigenous bankers must be barred." He is so emphatic in the condemnation of the indigenous banker that he says "*what India wants is an Act written not with a goose quill dipped in milk and water but with an iron pen dipped in the blood of the Mahajan* for until the banking system for which the Mahajan is responsible is dead India will not live." *Vide* "Souls of Good Quality" and other papers.

our business life. It has received rapid extension in all walks of life and it would be impossible to enumerate the different lines in which its services are requisitioned in civilised countries. One curious fact noticeable even in the advanced countries is the small use of credit in agriculture till a comparatively recent period. But it has already become as important a part of his business as his scythe, his cattle, plough, etc. In the entire chain of events from sowing down to selling the crop, the help of a sympathetic money-lending agency is necessary.

The function of credit in agriculture.

Credit is needed for the agriculturists both for short-term, intermediate as well as long-term periods. So long as agricultural business is not understood as providing essentially for a market but is conducted purely for family needs of the agriculturists living in a self-sufficing economy stage much capital is not needed. Improved seeds, fertilisers, improved cattle, and better ploughs are required if agricultural production is to expand. These require an outlay of money and there must be some credit organisation to satisfy the different credit needs of the agriculturists in a suitable manner at a low rate of interest conducive to the prosperity of the agriculturists and on the security that the agriculturists possess. Better farming and better rural business conditions would be denied if it is difficult to obtain sufficient credit at a cheap rate. An elastic rural financial system is necessary for the economic welfare of our agriculturists. Without it no capital can be sunk for irrigation, for manure and for efficient tillage instruments. There would be no increase of harvest, no thorough scientific exploration of land, no reserve working capital and no lowering of the costs of production.

Analysis of credit needs.

The funds required for agriculture are of two kinds. Fixed capital is essential to make permanent improvements in land, to wipe off the existing indebtedness secured by the mortgage of the land, to purchase cattle and to obtain a steady water supply by sinking wells. Circulating capital is necessary to keep the farmer in growing, harvesting, making current outgoings and marketing his crops. Fixed capital

can be secured by real estate mortgage which can be made repayable out of annual returns from the land. Other means can safely be employed to provide the short-term credit needs. But as India is unfortunately dependent on the monsoons there is very often a failure of the crops once in five years and during the lean years the provision of current outgoings is always difficult and the securing of capital to begin agricultural operations at the next season is rendered acute. Credit for such purposes must necessarily be of a longer period than short-term periods for growing, harvesting and marketing the crops. The repayment of credit for the intermediate period need not be spread over a long period as in the case of fixed capital sunk in permanent improvements in land.

Existing Credit facilities in this country.

It is imperative to examine the means available for the agriculturists to obtain credit for enabling them to continue seasonal operations in agriculture or to enable the agriculturists to effect some improvements on their land such as the adopting of machinery or improved appliances, modern scientific methods of farming, the building of financial reserve against low market prices and the allowing of land to lie fallow, the raising of better breed of cattle and the experimenting with other than the cheapest manures and the insurance of cattle.

The present system of financing the agricultural industry either for short-term or long-term needs is partly good, partly indifferent and very inadequate. The existing financial agencies are the village money-lenders, the co-operative credit banks, the Government directly granting loans and the zemindars owning the land.

Coming to the money-lender's methods it must be emphasised that as an agricultural banker he is an absolute failure. He is not interested in agriculture and measures for agricultural progress do not appeal to him. Of late the prosperous agriculturists themselves are turning to money-lending and they are ousting the village sowcar to a great extent but they are very avaricious and exacting. The Provincial Banking Committee's Reports of Madras, the Punjab and the U. P. speak most disparagingly of them.[16] He does not insist on

[16] See M. L. Darling, " Rusticous Loquitor."

prompt repayment in small sums. He is generally unsympathetic towards the sad plight of the agriculturists. His rate of interest is usually high.[17] He keeps no carefully-kept register which is subject to independent outside audit. Some of the professional money-lenders are unscrupulous and attempt to foreclose mortgages so as to obtain the farm at below its market value. The crop mortgage which is one form of security accepted is a vicious system subject to grave abuse. The agriculturist loses his independence and pays an enormous amount of interest as a result of the way in which the crop is manipulated by the money-lender. This system of continuous financial slavery can be evaded only when an unusually heavy price has been realised but it is very often the case that the agriculturist is seldom lifted out of debt. This line of credit is granted for current outgoings. The village money-lender is also the supplier of necessities and the agriculturists pay heavily for them. This uneconomic illegitimate and impoverishing kind of credit has to be changed. It is unwise to condemn the misuse of intelligence and the legal opportunities on the part of the money-lender for the money is often lent out for unproductive purposes on securities of doubtful value. A banking agency should however displace this unsympathetic credit-providing agency.

A more sympathetic lender of credit than the village money-lender is the Government of India. In addition to the indirect method of financing agriculture by facilitating the co-operative movement the Government of India has tried to finance agriculture by direct methods. By the Land Improvement Loans Act of 1883 loans can be made to the agriculturists for making improvements in land by sinking

17 Assam 12 to 75%, Bombay 12 to 25% rising to 50% in Sind, Bengal 10 to 37½ to and from 47½ to 300%, Bihar and Orissa 18½ to 37 ½% for cash loans 25 to 50% for grain loans, Burma 18 to 24% or 37 1/2 for cash loans 48 to 60% for grain loans. The C. P. 12 to 24% or 37½ for cash loans 48 to 60% grain loans, Central Areas secured 6 to 13½%, Ajmere-Merwara unsecured 12 to 18%, Delhi secured 12 to 24%, N. W. Frontier Province secured 6 to 18%, other cases 13 to 36¼%, Madras 12 to 24% rising to 36 to 48%, 6 to 12% for secured loans, the Punjab unsecured rates not mentioned but rise to any figure. The United Provinces 7½ to 12 1½ for commercial and Mortgage banks 18 to 37½ village Sowcar, 25 to 50% grain loans.

wells, cutting channels and purchasing agricultural necessities as seed, cattle and implements. The Agriculturists Loan Act of 1884 enables the Government to lend for general purposes and on such conditions which are usually followed by the co-operative credit banks.

Certain improvements are being introduced and the co-operative banks are being utilised as the channel for repayment of the loans. The attempt to make the co-operative societies or banks manage the loans which can be made by the Government under the Act of 1884 would introduce a desirable innovation for it leads to the freeing of the Government of certain responsibilities and would at the same time confer prestige on the local co-operative societies.

These Acts have failed in their duty for very few individuals alone can be benefited.[18] To secure these loans the borrowers have to fawn upon the officers whose rapacity forces them to deduct substantial sums from the original loans made by the Government. The process of obtaining loans through this machinery requires much time. As prompt repayment is insisted upon by the Government the loans prove to be unattractive to the agriculturists who have to subject themselves to several inconveniences. As the Moral and Material Progress Report of 1911 observes " these loans though large in the aggregate have not had any great influence on the agricultural credit of the country." Although the Royal Commission on Agriculture attempts to justify the rules with reference to interest rates charged on the Government " loans on the ground that they are based on rates offered for public loans " still it must be tacitly recognised that the relief the Government can afford will not only be limited in amount but the Government cannot hope to act as a suitable financial agency to the agriculturist.

The management of the co-operative credit societies has produced very good results. It is an undisputed fact that they form a substantial contribution to the solution of short-term credit requirements of the agriculturists. The recent World Economic Conference organised under the auspices of the League of Nations admits that " the best form of institution appears to be the co-operative credit society

[18] See the Report of the Royal Commission on Agriculture, para. 362.

operating by means of resources which the very fact of association enable it to procure and to increase with or without the assistance of the public authorities." The fascinating growth and real progress of the co-operative credit movement cannot be doubted by the most sceptical of its critics. But as the ideal temperament and requisite character required for its success are not to be found in all men some mistakes have been found to have crept in unconsciously. It is not only essential that these should be checked as early as possible but it should be realised that the present form of activity is suitable for the short-term credit needs of agriculturists and it has to be supplemented by other co-operative organisations which provide the long-term credit resources needed by the agriculturists. Government aid and mutual help are needed in the matter of developing a suitable agricultural credit organisation. Co-operative finance alone possesses all the desirable characteristics of agricultural finance as outlined by Sir F. Nicholson.[19]

A commercial bank is generally intended to facilitate the exchange of things of definitely ascertained value already in existence. The shortest period needed for agriculture is too long for commercial banks. Agricultural pests, diseases of crops, storms and price fluctuations may reduce the value of their non-liquid security. Thirdly, the Indian agriculturists are bad bank customers. The small size of their farms, the non-transferable occupancy of the holding, their unbusinesslike habits and lack of education, are serious handicaps. Lastly, the Indian Commercial banks find ample scope and outlet for their funds without catering to the agricultural interests. It is impossible to finance landowners by the deposits of commercial banks. This would force them to call in the loans at any inconvenient time for the agriculturists. Still loans by the joint-stock banks are often made to larger land-owners and the planting community on the security of agricultural land and to others who possess tangible, marketable security. The Central Committee Report as well as the foreign banking experts echo selfsame causes and plead for a sympathetic financing agency for these agriculturists.

Barring the Dawson's Bank operating in the Irrawady Delta of Burma there are no agricultural banks in the country. But the

[19] See his Report on Land and Agricultural Banks, Vol. I, p. 3.

success of this bank [20] is due to its first mortgage security, secured and steadily marketable harvests, valuable land, proper supervision of borrowers' application of loans for productive purpose, prompt collection of interest and loans on system of instalment and the absence of competition. Without such an ideal environment the agricultural banks are bound to fail.

Lastly, the enlightened zemindar is another source to whom the agriculturist can appeal. But most of these are heavily indebted and much cannot be expected from the absentee landlords. The system of co-shares in landed property itself acts as a deterrent in the matter of investing on land and even the more educated landlords seldom do anything in this direction on lines followed by the English landlords.

Facilities in other countries.

All progressive countries have made distinct and elaborate provision for financing the different credit needs of the agriculturists. Germany was one of the first countries to develop elaborate and well-planned credit machinery for financing the credit needs of the agriculturists. The old and the new Lanchschaften of Germany [21] have been used as the model for the latter-day credit developments of other countries. The Landschaften and the Credit Foncier of France have been the models on which other countries have based their mortgage credit bank for agriculture.

The *Landschaften* of Germany are long-term credit banks which were first organised about the end of the 18th century. They were co-operative banks formed by the landlords of a province with the main object of obtaining credit for making permanent improvements on land. The collective mortgage of land furnished the needed security and the unlimited liability attached to the members enhanced the value of the security and the bonds sold to the public. The executive committee managed the business and those who had the requisite legal knowledge got payment for their business services while others have

20 See the Report of the Royal Commission on Agriculture, para. 422.

21 See H. T. Herrick, " Rural Credits," pp. 1 to 210. See also the miscellaneous articles on German Banking published by the American National Monetary Commission.

only travelling charges alone for conducting the business of the banks. The Government inspected the banks. The *new Landschaften* are ordinary mortgage banks but they possess no share-capital earning dividends. They are merely syndicates of land-owning borrowers acting as intermediaries in providing capital on the basis of the guarantee which however is granted after proper testing of the credit of the borrower and the value of the security. These charge only $1\frac{1}{4}\%$ commission for this service. They are confined to definite localities and the officials know the men and the land values throughout the district. The loan is granted usually to a limited extent of the value of the land. These banks are the agencies through which the bonds based on the land are sold. As these debentures are based not only on the specific piece of land but by the mass of mortgages floated by the society they are secure. If interest is not paid the debenture-holder can request the Court to set aside specific mortgages to pay the due interest. There is no right to demand payment on the part of the debenture-holder but the banks can withdraw them and make provision for repayment. The 4% debentures are sold above par and as cheapness is the object the old debentures are recalled and fresh ones issued at a low rate. Loans are repayable by annual payments usually in or about 53 years. A slight contribution towards reserve, guarantee fund and expenses has generally to be made along with the amortisation payment and the amount of interest. The working fund is formed by contributions made from the expenses of management and any special resources. These banks have the right to take possession of the property and force a sale without resort to regular judicial proceedings. They are manned by semi-official officers who are endowed with judicial and executive powers on all matters concerning the banks and the member borrowers. Heavy penalty can be imposed for any infringement of the rules. The *Central Landschaften* was created in 1893 which buys the debentures of provincial Associations taking an assignment of the underlying mortgages and issues its own debentures which find a ready sale in the money-market. The chief system of credit has made it possible for Germany to create landowning farmers. In other countries like England, Japan and France where no such elaborate credit system exists the landowning farmers are only the exception. "Even France, the classic land of the peasant proprietor has only 52·8%

of its land cultivated by the landowning cultivators," remarks Morman.

In Modern Germany agricultural mortgage credit has been rehabilitated to a great extent by placing suitable public money for long-term investment in their line. The postal service and some of the social funds have utilised their resources in this direction. The Gold Disconto Bank has taken up mortgage bonds worth 100 million marks from the Rentenbank Credit institution. The individual private and public mortgage banks undertake to distribute this credit through their agency and the farmers pay 7½%. The Official Pensions Fund of the Reichsbank was invested to the extent of 80 million marks in agricultural mortgage. Mortgages are admitted as collateral for loans and percentage of collateral for loans was raised from 50 to 75%. In May 1926 the Reichsbank declared its willingness to back up short advances made by the Central Organisation of Prussian Co-operative Banks on stored grain. These measures enable the agriculturists to withhold from selling the harvest at disadvantageously low rates.

In addition to the landschaften or the co-operative land credit associations groups of mortgage companies are organised by states, provinces and municipalities which grant real estate loans. The Stadtschaften are urban co-operative associations dealing with urban real estate credit. Again co-operative organisations specially designed for supplying credit to small and medium-sized business have been created since 1924.

Though German Bonds are issued abroad they are for comparatively small amounts and the home investors are taking increased interest in mortgage bonds and their popularity would have indeed been increasing if they had had the necessary capital to direct into this channel.

The Example of France.

The Credit Foncier of France was started in 1852 and remodelled in 1854. It acts as an apex bank for the mortgage banks in exactly the same manner as the Central Bank of France does for the commercial banks of the country. It enjoys special legal privileges granted

[13] See Dr. H. Schaat " The Stabilisation of the Mark," pp. 208 to 210.

to it by the State during 1853 and 1856. Besides it is being closely supervised by the Government. The Government appoints the Governor and Deputy Governor of the Bank. Government Treasuries are to be used for receipt of its dues, deposits and surplus funds. It has to pay reduced stamp duty on deeds of registration, transfer of debentures, etc. Even trust funds can be invested in these debentures which can be floated up to 50 times the nominal capital. No registration of its debentures at the end of every ten years is needed. The bank by its system of "Purge" can bring to light any hidden claims on land and free the title of the real estate from all possible claims of third parties. Its debentures are repayable to bearer with no fixed time of maturity and repayable with bonuses and prizes. It need have no recourse to ordinary legal procedure for recovering its loans. Its loans are the first lien on land and the maximum rate of interest it can charge is five per cent. Mortgage loans for long as well as short periods ranging over ten years can be granted by it. It is privileged to make any system of loaning for agricultural improvement after securing the required sanction of the Government.[23]

It founded the Credit Agricole in 1860 which however was absorbed in 1872 by the Credit Foncier itself. In 1882 it bought up the Banque Hypothecaire and at present the provision of long-term credit is made through the regional banks which guarantee the loan and on the mortgage of land the loan is made repayable within the course of 25 years. From 1910 even private individuals are allowed to secure loans to improve their rural properties through these regional banks. Loans up to 800 francs can be made and are repayable within 15 years. In 1920 this system was extended and the maximum loan was fixed at 40,000 francs repayable at the end of 25 years and the maximum interest for the loan is 2%. The regional banks are to observe a proper distribution of their resources between short-term credit (25%), intermediate credit (10%) and long-term credit to individual small holders (32½%) and the remainder in long-term credit to societies. The regional banks can lend their capital and reserve for short-term

[23] It is now the National Imperial Mortgage Bank of France operating in France, Algeria, Tunis and Morocco, the French protectorates and the Mandated Territories. The formation of a similar Imperial Mortgage Bank for the British Empire was suggested.

credit purposes. There is additional legislation improving the National Office for Agricultural Credit to set aside 600 million francs for encouraging and distributing electrical power in rural districts. Agricultural Savings Banks are organised to encourage rural inhabitants to pay *an old age annuity* and the local Agricultural Credit Fund undertakes all the legal operations in connection with these Savings Banks, transmits funds to the National Office Age and the L. I. Funds. The Agricultural Credit System is thus made to act as a useful clearing house for a system of old age savings. Ex-service men are given special facilities to settle on land and to invest their gratuity of 5,000 to 10,000 francs in such a holding. Long-term loans are granted to them by the L. V. Fund.[24] Long-term credit for agriculture through this system has proved a complete success. If India can hope to encourage its rural population eking its livelihood by means of small holdings it is essential to see them organised on a co-operative basis for securing credit. India however has to avoid the chief defects of the French Mortgage system, *viz.*, excessive centralisation in Paris, its susceptibility to political influences and lack of sufficient decentralisation.

The Example of the U. S. A.

The United States of America realised the importance of agriculture so long ago as 1800. The Federal Government made provision for the capital required to enable a farmer to purchase land and carry on his operations.[25] For about 20 years it dispensed with public land on a credit system. But until 1863 no serious attempt was made to establish sound banks to finance agriculture. The so-called "wild cat" banks issued their notes during this period but the resulting chaos was so great that the N. Bank Act had to be passed. This Act did not confer any special privileges on the farmer but there was no discrimination against him. But as the initial capital required for starting a National Bank was fixed at \$ 50,000 the farming districts could rarely afford to gather so large a sum. The law relating to the loaning busi-

[24] For having a complete view of the provision of 1920 recognition, see the I. L. Review 1925, June Number, pp. 852-854.

[25] See Year Book of the Department of Agriculture, 1925 (Washington).

ness also condemned the making of loans on real estate. The State Banks which were hitherto supplying rural credit were impeded by the levying of a ten per cent. tax on their note-issue. Since 1900 the banking law was amended to favour the farmer. The minimum capital required for starting a National Bank was reduced to $25,000 for towns with inhabitants below 3,000. (*b*) In 1912 the National Banks were empowered to lend on real estate to the extent of the capital *plus* the reserve or 30% of their time deposits. (*c*) The Federal Reserve Act authorised the F. R Banks to rediscount nine-months agricultural paper. In 1916 the Federal Farm Loan Act was passed. It instituted 1 2 Federal Land Banks in selected districts. Each was to start with a capital of 250,000 partly financed by the Government. The F. Farm Loan Board appoints four directors (the Secretary of the Treasury being an *ex-officio* director) to control the system. 4,500 National Associations were started and each association consisted of about 10 or more land-owning borrowers who subscribed 5 per cent. of their loan in stock which carried double liability with it. These Associations combined to start the Loan Bank and guaranteed the mortgage and each Federal Land Bank has to guarantee the bonds and coupons of others. The bonds floated by the F. L. banks are tax-exempt and are eagerly subscribed for by the public, as the Federal Government closely supervises the issue of the bonds and sees that no F. L. Bank floats beyond 20 times its capital and reserve fund put together. The bonds are in denominations of $ 50,100,500 and 1,000 and in larger denominations payable any time after the end of 10 years if the F. L. Bank elects to do so. Loans are granted on first mortgage up to fifty per cent. of the value of the land and 20 % of the value of permanent insured improvements on land. The loan period ranges from 5 to 40 years and the loan is repayable on the amortisation principle.[26]

So far as short time and intermediate credit are concerned the F.R. Banks can rediscount agricultural paper repayable within nine months or less. An indefinite number of joint-stock land banks have also been organised. In the north and north-western parts of the U. S. A. the local and state banks furnish credit to farmers on personal notes, chattel mortgages or other acceptable security. Farmers own

[26] See the J. B Morman, ' Rural Credit in the U. S. A. and Canada."

these lands and operate them mainly with the idea of securing credit for genuine rural improvement purposes. The rating of the agriculturists' credit is being discussed and when this is accomplished the banks can safely lend on agricultural paper. Trust and Insurance companies also conduct long-term loaning on farm mortgage business. In 1921 the War Finance Corporation was empowered to finance the export of agricultural produce and to meet the long-term needs of the agriculturists for a further period than 6 months and up to three years. A permanent live-stock loan system is being organised to fill in the gap that would be created by the dissolution of the W. F. Corporation. In 1923 twelve Federal Intermediate Land Credit Banks were started to finance the agricultural needs which would be of short duration and do not warrant the long-term credit of the F. L. banks. Thus within a period of fifteen years an elastic rural system of credit was created as a check against hard days and unreasonably low or declining prices of agricultural produce. These loans can be repaid as times get better. In addition to this Federal Government's solicitude the rates also make provision for granting long-term loans on mortgages to the agriculturists. The money for this is being secured by the sale of public lands. State Land Banks have been started in New York, Missouri, Colorado and Indiana, South Dakota and Montana are attempting to build a rural credit system in which funds have to be loaned on farm mortgage to be secured through the sale of state bonds.

During the years 1933 and 1934 Agricultural recovery is being facilitated by better financing of farm mortgages through reorganised farm bank agencies, extension and development of the farm co-operative movement, effective control of crop surpluses, the treatment of every constitutional measure which will tend to increase the sale prices of agricultural goods far above their real cost of production and the protecting of the farmers by tariff duties against destructive foreign competition. The special mortgage bond exchange which has been created is improving the marketability of the farm bonds.

Specialised building mortgage bonds and city real estates credit have also arisen but they are not subject to adequate government regulation. The recently passed Farm Credit Act of the U.S.A. aims at "eliminating mortgage lending by private interests and make such lending a government monopoly."

The Example of other countries.

It is not these old established countries alone that make proper provision for agricultural credit. Every newly settled state of Central Europe has made elaborate provision for agricultural credit both for long as well as short-term periods. In Czechoslovakia the Act No. 166 of March, 1920, systematises this state help Loans up to nine-tenths of the purchase price of land and one half of the value of acquired buildings can be borrowed. A specified bank for making these loans was created in 1923. Short-term loans are made direct to the co-operative societies by the land officers or to individuals through a Co-operative Bank on the surety of the Land Office. About 81,000,000 crowns were lent by the state while the private banks could lend only 50,000,000 crowns. In Jugoslavia an Agricultural State Bank has been formed for financing the short-term and long-term credit needs of the agriculturists. In Palestine the British Government has been organising a plan for starting a long-term credit bank.

The Dominion of Canada perfected its arrangements for agricultural credit in 1917. The Farm Loan Act organised a fund of $1,000,000 of which the crown is empowered to subscribe one half and advance the other half till the borrowing farmers who alone can be shareholders, come in gradually. A Committee of five manages the loaning business. Fifty per cent. of the value of land can be lent as a loan which can be repaid within thirty years. The interest on the loan is six per cent. The loan is repayable on the amortisation payment. The Committee is its own conveyancer in granting, hypothecating and cancelling mortgages. Loans are to be made for improvements on land. Cash can be raised by attracting deposits carrying 4% interest and issued to the public in various denominations ranging from 25 to 1,000 withdrawable at any time. Bonds for larger sums are issued carrying interest of 5% and these are secured by mortgage granted up to 90 % of the land value. The bonds are repayable by the end of the first year from the date of purchase. Both deposits and bonds are tax-free and are issued under the liability of the province. The Rural Credit Act supplements this Act and makes possible loans on personal security. Both these services are likewise considered to have proved successful. In Australia the Commonwealth Bank has a separate rural credit department for "granting loans for short periods on

primary produce" to corporations or associations engaged in agriculture.[27]

So far as the Union of South Africa is concerned the Land and Agricultural Bank was started in 1912 to extend help to agriculture Act 40 of 1926 extended the power of this bank to raise and use these funds for financing Agricultural Loan Companies and Rural Credit Societies.[28] The Central Board of the Land Bank can render other services to these rural credit societies in the direction of starting agricultural produce on which loans have been granted by the rural credit societies and in lending banking officers to organise the work of rural credit societies.

Switzerland, Sweden, Russia and Denmark also possess Land banks specialising in the granting of long-term loans. In Bulgaria the Central Co-operative Bank has two departments: one for insurance and one for credit. The funds for the credit department are supplied by the National Bank of Bulgaria, the State Credit Institute and the Agricultural Bank of Bulgaria. In Argentina there is a highly developed system of land mortgage banks. In Hungary and Denmark the land mortgage banks are flourishing institutions.

In Japan there is an efficient system of land credit. Long-term agricultural financing is entrusted to a special bank known as the Hypothec Bank of Japan (Nippon Kevango Ginko) which was founded in 1895 with an authorised capital of yen 94,000,000 and it has a paid-up capital of yen 69,876,000. It was modelled on the Credit Foncier of France and its sole business is to make long-term loans redeemable during fifty years on security of immovable property. Without security it can lend to the co-operative societies and public authorities. It can raise additional capital by floating debentures.

27 See the Commonwealth Bank Rural Credit Act of 1925.

28 See Section 13 the Act of 14 of 1926 the South African Union Parliament.

29 A good account of the Noble's Government Land Bank in Russia can be obtained by consulting the monthly Bulletin of Economic and Social Intelligence for September 1914, p. 77.

At present the Central Agricultural Bank undertakes the duty of helping the farmers to purchase live-stock and seeds and secure an improvement of land. It receives help from the states.

It carries on business through the agricultural credit societies. See S. S. Katzenellenbaum- "Russian Currency and Banking," pp. 186-188.

Both the President and the Vice-President are appointed by the Minister of the Government from among the directors and the Minister of Finance has a general control over the affairs of the bank. He has the power to fix the maximum rate of interest. Agricultural and industrial banks were established in each prefecture between the years 1897 to 1900. Part of the capital was subscribed by the shareholders and the remainder was paid by the prefectural authorities. They were solely meant to act as the local advisers of the Hypothec Bank. Like it they float debentures but they are essentially miniature banks drawing funds from the Hypothec Bank. In 1921 several of these were amalgamated and were treated as mere branches of the Hypothec Bank.

Even in disorganised China as it appears to be there is an organisation of labourers and farmers' bank in every district of the Shantung Province which was started in 1920 by the Provincial Assembly. The capital of the bank is graded according to the population living in the district. Two-thirds of the capital is to be made up out of subscriptions. The remainder is to be paid out of the Treasury. Loans are to be made to farmers and labourers. The bank is also permitted to receive fixed deposits, to accept instruments for safe keeping and act as fiscal agents for local officials. A loan is limited to $500 per individual or 1,000 per a corporation. The interest rate is fixed at 1% per month. Bonds can be issued to two times the amount of capital with the permission of the Ministry of Finance. There are a number of such banks in Taiku, Kishein, Wenshai, Fengang and Yunguing.[30]

Quite recently the Parker Willis Commission of the Irish Free State has recommended the establishment of a big agricultural Credit Corporation with a capital of £500,000 the subscribed portion of which is to be allotted to the State and the Commercial banks. Bonds and debentures issued by it are to be guaranteed both for principal and interest amounting to £1,000,000 in any year. Besides it has to act as a Clearing House for local co-operative credit societies, co-operative creameries and other co-operative marketing organisations and co-operate with the I.A.O. Society. Loaning to individuals or groups of farmers can be done only for securing improvements in land. It can

[30] See the Mysore Economic Journal, 1926, p. 127.

rediscount bills or securities in the open market. It can also administer Government agricultural relief measures. But above all it is incumbent on it to specialise in the business of providing long-term capital to agriculture.

Even in England the Committee appointed by the Ministry of Agriculture and Fisheries which has issued its report in April, 1926, makes provision for long-term credit. A Central Land Bank should be created for making long-term mortgage loans through the joint-stock banks and their branches. It can raise money for this purpose by the issue of debentures to the public. The bank is to be empowered to lend money up to a prescribed period upon the first mortgage upon agricultural land and buildings. A chattel mortgage on farm crops and livestock should also be created.

The survey of foreign banking systems shows that specialised institutions for agricultural mortgage credit fall into three classes, the co-operative, the governmental and the private joint-stock company. The State has to help every type of agricultural mortgage credit bank either by Government guarantee of interest on capital or by grant of special legal powers and privileges. As a State mortgage bank is not likely to be approved, the efforts in our country ought to be exerted in the direction of perfecting the existing co-operative land mortgage banks and erecting the joint-stock form of L. mortgage bank of the type which exists in Belgium, Holland, Switzerland, Germany and Spain, the U.S.A., Japan and England. If State assistance which is lent to co-operative L. M. Banks cannot be lent freely to the private Jt. St. land mortgage banks there is no use of frittering away our energy in starting private Jt. St. banks. A competent board of management ought to be available for managing Jt. St. banks.

The few co-operative L. M. banks which exist are still infant bodies. They ought to be strengthened and made to work as useful adjuncts to the co-operative short-term credit societies. The raising of debenture capital is being centralised in the hands of the P. apex L. M. bank. Closer contact between the P. L. M. Bank and the co-operative L. M. bank has to be secured. A suitable number of co operative mortgage banks will have to be started in all provinces. The Provincial Board of agriculture should be empowered to make the necessary alterations and needed improvements in the outline of the L. M. banking policy of the province for example in fixing the

Government control and help over the L. M. banks, the borrowing limit of members, the requiring of sureties, maximum amount of loan or the time length of the loan period, the checking of overdue loans from the L. M. Bank and these undoubtedly depend on the land holding and tenure system. The co-ordination of mortgage credit and insurance has not been attempted as yet. Side by side with ordinary amortisation a special form of extinction of mortgage debt by taking out an insurance policy from co-operative insurance societies has to be devised.

It should be empowered to issue debentures to the public based upon these mortgages up to a fixed proportion of its capital and surplus funds thus creating a recognised means through which capital might be invested in agriculture. Loans would be made through the-joint-stock banks and their branches which would act as the agents for the Central Land Bank. Similarly provision for short-term credit has also been perfected.

Recommendations.

It will be convenient to summarise what has in a somewhat platitudinous manner been dealt with in the above paragraphs. The main issues to which attention must be directed are:—

(*a*) The introduction of special agencies for the provision of long-term financing of the agriculturists.

(*b*) The Government of India should do something to improve the credit situation of the agriculturists. It is indeed true that it is not the duty of the State to provide money to assist private enterprise.[31a] Sir James Meston, an ex-Finance member of the Government of India remarked that the " land mortgage banks would be of much

[31] Since these lines were written the Agricultural Mortgage Corporation, Limited, was started in 1928. The Bank of England and other joint-stock banks have subscribed a part of the capital. The state has guaranteed a £ 750,000 capital, agreed to underwrite £5 millions of debentures and to invest £1½ millions in the debentures to be issued and to make a contribution to the costs of administering the scheme. The debenture stock of the L. M. bank is made trustee security.

[31a] The Bhawanagar model ought to be copied by the British Government. The State must discharge the creditors' claims.

value to this country. Everybody will recognise that it is a very different sort of institution from the ordinary commercial bank. It must be an institution which is financed very largely by long-term deposits in order to ensure that it shall not be embarrassed in its handling of advances to landlords and estate-holders. It is a type of bank which I do hope to see established in this country but I hope to see it done in every province started very largely by local enterprise and maintained under local supervision and control. It is the local knowledge and neighbouring control by groups of intelligent landlords that are going to make the land mortgage business in this country a success and I do not think that it is of any use for the Government to undertake work of this sort on a large scale."

But certain special features of the Indian agriculturists should be considered. Those who have sufficient landed property and security to be included in a system of mortgage banking are often sleeping partners having no inclination to borrow while those who do want to borrow are without any security against which debenture loans can be floated. The deep importance of flourishing agriculture to the state needs no emphasis and the prosperity of the agriculturist cannot be secured without any efficient and economic organisation of the industry which includes properly organised financial assistance as an integral part of it. Taking some of the above examples of other countries into consideration we find that the state had to do the needful in providing special and permanent machinery to facilitate the provision of long-term credit for the agriculturists. Our agriculturists are so sunk in ignorance and their methods of life are so different that they often fail to make out a case for themselves. It is erroneous to expect that the debt-ridden landlords would do everything in this direction. Several of the provinces have done the needful in this direction, by helpful aid in starting land mortgage banks. They have been giving the needed impetus for the formation of private institutions of land-owning agriculturists for the purpose of obtaining loans at cheap rates for the members on the common security of all. But there is no systematic organisation and they have not obtained any proper place in the Indian Banking system as a whole. A close-knit organisation specialising in the domain of long-term agricultural financing and co-operating with the existing co-operative credit societies which have to confine their activities solely to short-term and intermediate credit

of the agriculturists must be created in place of the present drift towards long-term financing of agriculture in this country.[32]

For the present the movement is confined towards the floating of land mortgage banks for securing long-term credit for the land-owning agriculturists only. But it is the duty of the state to float mortgage banks to help the agriculturists, *viz.*, tenants who have no right in land. The provincial Co-operative Land Mortgage Bank can float bonds on its own general assets and as land cannot be utilised as the specific basis of these tenants' mortgage banks a change in the method of procedure is essential. Security other than land can be taken from the tenants who do not possess any statutory mortgageable, saleable and transferable rights in land and this security can be supplemented if need be by *that of guarantors*.[33] The Mahajan or money-lender can be made to undertake this duty of repaying the debt to the land mortgage bank. Lending his own money as fixed deposits to the land mortgage bank he can supervise the issuing of loans by the land mortgage banks. Besides safety of his capital he can secure a higher average return on the turnover of his capital. He has to compulsorily co-operate with the land mortgage bank and the agriculturists. Other reserve funds that they (tenants) may hold may be used as security. The Government guarantee of interest would enable the Provincial Land Mortgage Bank to float debentures and the distribution of credit can be made by the Provincial L. M. banks to primary L. M. banks and the service of the existing co-operative credit societies can be enrolled in the direction of and supervision over the application of capital for productive purposes. A thorough and clean-cut division of the short-term and long-term loans is needed and the different kinds of the co-operative credit societies should be looking after this elaborate work and an efficient and sound division of labour would conduce towards the smooth functioning of these co-operative banks. As

[32] See the C. B. Enquiry Committee Report. For the present-day defects of the working mechanism see the Administration Reports of Provinces.—Chapter on the co-operative movement.

[33] Mr. Manu Subedar approves this suggestion and wants to build up a rural credit system based on the indigenous bankers acting as guarantors of the land mortgage banks.

remarked already it is indeed difficult to float land mortgage banks in the case of tenants whose possession is simply a part ownership in land. The cost of enquiries concerning title and enquiries concerning encumbrances and the risk of bad business would be heavier in this case. But these should not deter the organisers in any way. Their need for relief is no less urgent and as the work of the short-term co-operative credit societies should not be nullified by the crushing existing weight of indebtedness it is essential to formulate a scheme to free the tenants from the existing loads and give them a fair chance to prosper. Mortgage banks are indispensable concomitants to the present-day agricultural conditions and would be valuable auxiliaries to the co-operative credit societies specialising in short-term credit. If the rural tenants are to be converted into landowners, which is very essential to induce them to lock up capital from improving agriculture the land mortgage banks are absolutely necessary.

In Bengal 2 more L. M. banks, bringing the total to 5 have been recently started says the Annual Report of the Co-operative Societies for 1935. There has been slow progress due to poor response on the part of the ryots. Only 1,559 applications for loans to the extent of 399 lakhs have been made. Of these 962 had not been examined. 42 % of the remainder have been accepted and 65 applicants actually received Rs. 23,435, more than 2/3 of which was for the redemption of prior debt. The slump in land values, the reduction of debtors' capacity to repay, the existence of co-sharers amongst the tenants and landlords and the provision of the tenancy laws make this business extremely difficult. Without the scaling down of existing debts the granting of further debt would be merely ineffective or useless. The loans made are financed by the Provincial Co-operative Bank and no debentures have been floated as yet.

In Madras the L. M. Banks experience the parallel working of the Government officers under the A. Loans Act as a sort of hindrance. Taking a loan from L. M. bank means compulsorily subscribing to the capital of the L. M. bank and the interest rate of 6 % is higher than in case of Government loans. Hence loans are now being taken from the Government to discharge loans secured from L. M. banks. The shift from one agency to another is bad and arises out of competitive working of both agencies in the same area. A better ideal would be to eliminate this competition and spread the agencies

over as wide an area as possible. The period of loans should be the same in both cases (20 years) and the interest same in both cases which can only arise when the cost of making enquiries is not to be paid by L. M. banks. The Government agency should confine itself to those districts where L. M. banks are not in existence. The Government funds available might be disbursed through L. M. banks. All other provinces and states should learn a lesson from this experience and secure a co-ordinate working of both agencies. Borrowers should have access to a single lending agency. Government should help the L. M. banks by granting additional staff and purchase of debentures.

(*c*) Recognising the cardinal fact that the land mortgage banks should be neither philanthropic institutions nor pure capitalistic mechanisms, it should be the endeavour of the people to create Provincial Land Mortgage banks with a reasonable amount of share capital. They should act as the apex bank for the smaller regional land mortgage banks of five to ten villages so that competent management may not be sacrificed. These banks should consist of land-owning borrowers or tenants. The former have to furnish land as security of the loan while the latter have to furnish other property or reserve funds as the security. This security has to be properly valued by duly qualified appraisers and the loan is to run for a period of 15 to 20 years and the borrower has to repay it by easy half-yearly payments or clear off the debt all at once if he has the means to do so. The borrower has to pay a slightly higher rate than what the bank pays so as to provide for a small margin which can be spent for management expenses, reserve funds, valuation money and other necessary fees. Loans are to be limited to half the market value of the land. The loan is to form the first lien on the land or the collateral security ranking first in priority to all other claims except the land revenue demand of the state in case of land-owning borrowers. The duty of the borrower is not to allow the land to depreciate in value and deteriorate in capacity. He has to systematically pay interest and the amortisation payment regularly till the end of the period.

(*d*) The Government supervision of the land mortgage banks started under the Co-operative Societies Act should be vested in a separate department controlling the land mortgage banks which should

be granted the following important privilege. The bonds floated by the land mortgage banks would command ready sale in the market only when the state guarantees the interest as was done in the promotion of railways in this country. These can be included under trustee securities and the Charter of the Central Bank of Issue can make provision for these bonds being considered fit for the Central Bank to make its own investment.[34] Even the Insurance Companies on the look-out for the long-term investment can safely lock up their funds in the purchase of these bonds. The state has to organise an efficient system of land transfer,[35] and the registration of title should be established. Special privileges about execution and foreclosure, exemption from stamp duty, registration and court fees, income-tax and provision for transfer of funds should be granted. Such special privileges are enjoyed by the land mortgage banks of other countries. State guidance and superintendence are needed [36] in the initial days when, " men of local experience, local knowledge and superior skill do not become members of the co-operative land mortgage bank."

[34] So far as the 1873 Reserve Law of the Swedish Riksbank is concerned the Bonds of the Royal Mortgage Banks, the Swedish Cities Mortgage Bank and other domestic bonds quoted on foreign houses can be held as part of the non-metallic reserve against which notes can be issued. See Spalding, " Dictionary of World's Currencies," p. 183. The author's suggestion does not amount to this but as the investments of the C. Bank these should be considered fit.

[35] The Government has to maintain a register of the properties within its jurisdiction together with the names of the owners and particulars of the encumbrances in each case. On the faith of this register the Government can protect all purchasers or mortgagors against adverse claims. This is *Registration of title*. This is far superior to private investigation of title or the insurance of title. Certificates have to be issued to the land-owners and the vendors have to produce this to satisfy the purchaser or mortgagor and give him authority to inspect the register. A new land certificate will be issued to the purchaser or mortgagor after the completing of the sale or mortgage transaction. In Australia it was introduced by Sir Robert Torrens and the title is known as "Torrens Title." Registration of title to land exists in England, Germany and Austria-Hungary. See Encyclopaedea Britannica, Article on Land Registration, Vol. 16, p. 165 (11th Edition).

[36] The Baroda Committee postulates the necessity of too much state aid. "There should be government purchase of Rs. 4 lakhs worth of shares, government underwriting of 10 lakhs of rupees of worth of debentures, bonds, government guarantee of interest and full value of bonds, government assumption of the expenditure of management for the first five years, exemption of bonds from income tax and stamp duty and their registration as negotiable instruments." Undoubtedly there is too much of state spoon-feeding under this arrangement and the independence of the L. M. banks would be very much jeopardised.

A Provincial Board of Agricultural Advisers should be created to outline the general policy underlying these institutions. So long as the Board of Agricultural Advisers sees that the total amount of bonds floated by the General Land Mortgage bank is never greater than 20 times the paid-up capital and its reserve the business would be on a stable basis. It should co-operate with the Board of National Investment which has to look after the marketing of these bonds and create the investment habit on the part of the people. Without adequate financial help, control, fiscal and judicial privileges, propaganda and professional help from the other technical departments of the Government the land mortgage banks cannot succeed. Such has been the experience of other countries and would undoubtedly be the same if the Provincial Governments and the Government of India do not recognise the urgency of their development. It has been stated elsewhere that a Rural Credit Department has to be organised in the case of the newly started Reserve Bank. This department can centralise the nature of the work which consists in raising debentures and allocating them to the different provinces. The possibility of floating debentures in foreign money centres can also be undertaken.

It is unwise to leave the agriculturists to the tender mercies of the sowcars so far as mortgage credit is concerned. It alone can eliminate the chances of conflict between the borrowers and the lenders.

The object of land mortgage banks is not cheap credit but the elimination of such hostility. Collective guarantee with excellent security is the basis of their operations. Vigilance and control are their only proper safeguards. Land mortgage banks started on a limited liability basis and working on the above lines are essential for our agricultural prosperity and a slight change of Section 4 of the Co-operative Societies Act of 1912 is needed.

Some people consider that co-operative land mortgage credit is a sordid and unpleasant task devoid of all moral and higher education and they deprecate all attempts towards the starting of such institutions. But sentiment should not be the guide in such a vital matter as this.

[37] *Vide* the Report of the Royal Commission on Agriculture.

Our agriculture needs considerable development so as to be able to furnish the needed food to our increasing population. Co-operative land mortgage is one important method which leads to the perfection of agricultural long-term credit requirements.

This machinery for long-term credit must be conducted on right lines. The necessity of borrowing for productive purposes instead of clearing off previous debts alone must be placed before the borrowers. Secondly, the price paid by the agriculturists for this kind of credit must be lower than the average return of investment he can secure from the agricultural enterprise. Thirdly, integrity, knowledge of land mortgage business, proper valuation of land by the appraisers and an efficient Provincial Board to issue bonds and a proper, thorough and adequate examination of the different land mortgage banks by this Board and the undertaking of proper preventive measures to be enforced on the land mortgage banks, are essential for the success of the land mortgage banks. Fourthly, during days of agricultural depression the value of land would depreciate. The value of bonds may deteriorate or they may find no buyers at a fair price. But this would only be a temporary phase and the land mortgage banks must have wonderful strength to bear such a strain. Land values would generally be on a stable basis in this country. As population increases land values may advance in the near future and the land appraisers would have to be careful in studying the problems arising out of the market value of land. Everything depends on the Provincial Board of the land appraisers who have to see to the proper working of the land mortgage banks and check them from making unwise use of loans. It is the duty of the agriculturist to improve his efficiency and inspire the investors with the belief that his land is a self-sustaining mortgage. The deposits that are taken by the land mortgage bank ought to form only a small portion of the total working capital and may be utilised for keeping up its engagements with the debenture-holders if borrowers are lax in the matter of repayment. The equated annual payment system extending over 20 or 40 years and covering interest as well as principal has to be adopted in the matter of repayment by the borrowers. If other floating assets are also mortgaged to the bank there is no reason why they should fail as a result of default on the part of the borrower or a mistake in the valuation of land. A proper provision for a sinking fund to cover

the debentures would make them popular with the investors. An excessive issue of debentures would tend to depreciate the value of the bonds and raise the interest rate at which new bonds or debentures can be issued. A Sinking Fund arrangement would enable the real investors to sit tight over these debentures and undue fluctuations in the market value of the debentures would disappear. Above all the co-ordination of mortgage credit and insurance has to be attempted. It is not mere holding of land mortgage debenture bonds by the ordinary insurance companies alone that is needed. Side by side with ordinary amortisation a special form of extinction of mortgage debt by taking out an insurance policy from co-operative insurance societies has to be devised. Complete dismortgaging would automatically ensue out of this step in case the insured dies. Even the Stock Exchanges should freely allow transactions in the mortgage debentures floated by the L.M. banks.

Of what avail would be the inauguration of a new policy of agricultural development [37] if there is no credit machinery to enable the agriculturist to make use of them. Scientific researches and practical demonstration of improved methods of farming are steps in the right direction. But they must also provide the needed credit for the agriculturist who is now in the throes of poverty. If any full advantage of the Government Agricultural Department can be taken the land mortgage banks would have to use their influence in improving husbandry and devoting part of their reserve funds for experimental purposes. The greatest service the land mortgage banks can render to the agriculturists consists in the lowering of the rate of interest to a low level and make possible the undertaking of several improvements on land. The passing of Debt Conciliation Acts as in the Central Provinces, the amendments to the existing usurious Loans Act and Money Lenders Act would merely delimit the ability of the creditor to squeeze the agricultural debtors. The credit facilities for agriculture can only be adequately raised by the formation of the long-term mortgage banks and the short-term co-operative credit banks. A clean slate in the matter of existing indebtedness has to be secured by debt-conciliation and redemption schemes pushed through after an intensive debt enquiry. Debt-conciliation measures

[37] Vide the Report on the Royal Commission on Agriculture.

can be undertaken through the land mortgage banks. A Rural Insolvency Act would also improve the position greatly.

Working hand in hand like the Proverbial Siamese twins the co-operative land mortgage banks and the co-operative credit societies may be able to successfully tackle the problem of our agricultural indebtedness.[38] That incidental economies in the matter of superior staff and office rents can be secured if the Central Banks of the co-operative credit movement were to undertake land mortgage business has often been stated. This is indeed a cheese-paring policy alone. Easily obtainable credit is not the sole panacea for the numerous ills of our agriculturists. Credit is an important factor and seasonal variations in prices can never be smothered out except by better credit and transport facilities. Solutions should be sought in other directions to solve the complicated problem of our agricultural indebtedness but these lie beyond the province of the banker.

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[38] Sir Daniel Hamilton rightly remarks that the " Indian Ryot carries a mountain of debt on one shoulder and a mountain of illiteracy on the other shoulder." One way of benefiting him is to educate him and teach him the powers of organisation and he would be able to solve his indebtedness question. Other remedies like improved methods of agriculture and development and subsidiary industries may also help him. See my monograph On the Future of Our Agricultural Industry, Welfare, published from May 1926 to June 1927.

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CHAPTER XIII

THE INDIAN POST OFFICE SAVINGS BANKS

The rise of the P. O. Savings Banks—Their object—Their limited progress—Their banking progress—Suggestions for increasing their utility—Comparison with England—Appointment of a committee to discuss the feasibility of a few suggestions—Statistical tables showing the growth of the P. O. Savings Banks.

The Rise of the Post Office Savings Banks.

The existing system was a gradual development out of the Government Savings Banks which were started in the Presidency Towns between 1833-35.[1] Their management was transferred to the Presidency Banks between 1863 and 1865. In 1870 their system was extended to certain selected districts where they were instituted in connection with the District Treasuries. A uniform type of these savings banks was introduced in all other parts of the country in 1862. These absorbed the business of the District Savings Banks in 1886 and that of the Presidency Banks in 1896.[2] From that date forward the Savings Banks have been managed by the Postal Department. All accounts are treated as at call as in ordinary banking. No special reserve is maintained against these deposits. The deposit money constitutes what is known as "unfunded debt"[3] and is a floating charge on the credit of the Government. The deposit money

[1] While the classification of the public debt into *unproductive* and *productive* debt is well understood by the people the difference between the funded and unfunded debt is not thoroughly grasped. Funded debt refers to the obligation of the Government which can be repaid after a certain number of years, or those items which do not carry the obligation to repay the principal. Unfunded debt means the obligations of the Government which are to be repaid within a year of the time they are incurred. It is also usually known as the floating debt. The following table shows the growth of unfunded debt under this heading alone :—

In lakhs of Rupees.

year	1921-22.	1922-23.	1923-24.	1924-25.
	Rs.	Rs.	Rs.	Rs.
P. O. Savings Bank Deposits	2,226	2,320	2,498	5,273
P. O. Cash Certificates	434	312	841	1,311

[2] See the Fifth Decennial Report of Moral and Material Progress in India, p. 302.

[3] See the Author's Book, "Organised Banking in the Days of John Company."

is utilised for capital expenditure. The savings of the poor are used for purposes remote from the benefit of the depositors. It also leads to the placing of "all eggs in the same basket." Although there might be a sudden run on these P. O. Savings Banks the Government can meet it without any great difficulty.[4] The adoption of the remedy which the French P. O. Savings Banks adopt during such period which consists in the insisting of 15 days' notice for all deposits above 50 francs would be of signal use and would tend to check any depreciation of Government credit at such times.

Object.

The chief object with which they were started was to inculcate the habit of thrift among the working people and the middle and lower sections of the community. Good social and domestic results would be reaped if the number of provident people having savings bank deposits were to be the rule instead of rare exception as at present. Direct encouragement to investment is given by the granting of interest which is 2½ % on call deposits. In these days of low interest the reduction to 2½ % need not be a handicap. Since these lines have been written the rate of interest has been reduced to 2 % in April, 1936. The limit up to which an individual depositor can place money is Rs. 750 within the course of an official year. The individual amount of deposit cannot be more than Rs. 5,000. The Government gives the depositor the option of converting his money into government paper if he so likes.

Nearly seventy-five per cent. of the depositors do belong to the professional classes and the intelligent middle class people avail themselves of these Savings Banks and it is only very few of the agriculturists that make use of these banks. Their ignorance and illiteracy stand in the way. The present low rate of interest is not sufficient inducement to compel them to retain their savings here.

[4] There were four such runs made on the P. O. Savings Banks during the Russian Scare of 1885, the famine days of 1896, the boycott and Swadeshi agitation days of 1907 and in 1914 when the German Government confiscated the Savings Bank deposits in their country there were sudden runs on the P. O. Savings Banks.

Mortgage and pawnbroking business pays more and even the ladies of wealthy families and successful lawyers do utilise their savings in this lucrative money-lending business. So long as mortgage banks, specialising in this particular line, are not started the investment of savings in these banks or the Indian joint-stock banks cannot be expected to increase. The possession of land confers peculiar social status and much money is consequently invested in the land mortgage business. So long as these habits dominate it is hard to expect any increase in the banking habit of the people.

Their Limited Progress.

Sir H. B. Smith's Committee writes, " we are impressed by the comparatively insignificant figure of the total deposits in the Post Office Savings Banks amounting to only 24½ crores on 31st July, 1914, before the conditions that ensued on the outbreak of the war led to the heavy withdrawals. We understand that the substantial increase in deposits in the years 1912-13 and 1913-14 amounting to over four crores was due mainly to the grant of additional facilities and in order to increase them the Government of India should examine how far notwithstanding the admitted administrative difficulties it may be possible to improve the present procedure for the deposits and withdrawal of money and to increase the number of post offices conducting savings banks business.[5] Roughly 13,000 P. O. Savings Banks exist with about 25 lakhs of depositors depositing some three crores of deposits.

Their Banking Services.

The banker's interest in the matter of the P. O. Savings Banks does not confine itself only to their deposit-attracting function, and the promoting of thrift among the working and middle classes These banks undertake internal remittance work, facilitate the transfer of small sums of money from place to place by the money order system.[6]

5 Sir H. B. Smith Committee's Report, p. 32.

6 The present fee for sending ordinary money order is graduated as follows: on any sum not exceeding Rs. 10, annas two; on sums exceeding Rs. 10 but not Rs. 25 the charge is annas four; on sums of Rs. 25 if the remainder is less than 10 the charge is annas two bu if it exceeds Rs. 10 the charge is annas four.

The Government follows the well-known clearing principle in the matter of this business. It sets off payments in opposite direction against the other and these obviate the necessity of sending coin or currency notes. As a matter of practice it has realised that amounts remitted to and from a town very often balance one another during the course of the week.[7]

The Government P. O. Savings Banks also provide for telegraph money order facilities, Rupees 600 being the maximum limit up to which they can be issued. Those T. M. O.'s must not include a fraction of the rupee. The Ordinary fee plus a telegraph fee is charged. The practice of remitting money-order commission fees when land revenue is paid has to be further encouraged.

The Post Office provides facilities for making remittances abroad. The Postal order transactions between India and foreign countries are too well-known to need any description and analysis here. Funds are remitted from Mesopotamia, Persia and Ceylon through the Post Office and the import of funds annually through the Post Office has to be noticed.

The Post Office Savings Banks are literally the bankers of the poor and even investments in Government stock are facilitated to a certain extent. As the "democratising" of public credit would be the chief advantage of a wide-spread extension of this habit every encouragement should be afforded in this direction. Public credit can become easily stable and the Government loan policy would always succeed if only these depositors become more familiar with Government stock.

Sometimes back even bullion shipments to and from India were undertaken on behalf of the Anglo-Eastern Banks by the parcel post. By this means a parcel of five hundred sovereigns was sent at a very small cost of 6*s*. 5*d*. and the shipping companies finding the extended use of the parcel post being resorted to for this business protested against this use. The Government declared it illegal and a notification

[7] Before the inauguration of the money orders system in 1880 the Governmen Treasuries issued bills of exchange current for 12 months upon one another and as there were only 283 offices of issue and payment it could not satisfy the requirements in any way Currency notes were consequently sent by post as a safe and cheap method of remittance—See Geoffrey Clarke, The Post Office of India and its Story, Chapter VII.

was soon issued prohibiting the transmission of more than £5 of gold in any one cover.[8]

Sir Edward Brabrook styled the Savings Bank deposits as " infantile efforts in thrift" and it is well-known that people who have been broken to thrifty habits pass on to other agencies for investing their money. The progressive stages in the development of thrift might be denoted firstly, by the money-box, secondly the savings bank deposit, thirdly, the ordinary commercial bank and finally, wider investments. The steady growth of savings depends on the fact that people have confidence in the savings bank and that opportunities exist in a large number for investment in these banks.

Suggestions.

Unfortunately in this country we have only the savings departments of the commercial banks, the Imperial Bank of India and the Postal Savings Banks to handle the savings of the people. In other countries the savings departments of the Trust companies, building and loan associations and municipal savings banks compete with one another for this business. So far as the United Kingdom is concerned there are three great national agencies in addition to the joint-stock banks, building and co-operative societies and Investment Trusts, Penny Banks, School Savings Banks [9] and thrift clubs and Railway Savings Banks. While the big investing classes are the clients of these institutions the small investing classes are encouraged to invest their Savings in the Trustee Savings Banks, the P. O. Savings Banks, and the National Savings Organisation. The Trustee Savings Banks are now numbering 131 with numerous branches and sub-offices numbering 437 located in thickly populated areas. These date back to the beginning of the 19th century. They are started by individuals actuated by purely altruistic motives and from 1891 a statutory inspection of the working of these T. S. Banks was organised by the State. Numer-

[8] I. Hamilton, " An Outline of Postal History and Practice," p. 32.

[9] France pioneered the way in this direction and in almost all the European countries the school savings banks exist. These aid rather than retard private banking enterprise for the initial training would promote, develop, foster and implant habits of thrift and industry.

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ous acts were passed since that year. The latest was in 1930. The savings were invested through the N. Debt Commissioners. The deposits of the poor classes were paid 2½% rate of interest and the P. S. Banks were allowed to obtain £2 12*s*. 6*d*., the additional sum being intended solely to cover the costs of management. The larger T. S. Banks have their own investment department and require one month's notice from the depositor to withdraw his deposit. Three and half per cent. is allowed to the depositor and the National Debt Commissioners have to sanction the investments made by the T. S. Banks. They also undertake to carry out the individual investment in certain classes of Government stocks specified by statute. The holders of the investments receive all the benefits of this investment. The following figures speak eloquently of the progress of the investment habit.[10]

Ordinary Depositors.

	1915.	1924.
No. of ordinary depositors	1,966,730	2 295,535
Amounts of deposits	£51,412,370	£82,285,044

Special investment deposits.

No. of depositors	107,564	120,604
Amount of deposits	£15,337,281	£24,753,347

Individual Stock Investment.

No. of Investors	90,017	256,871
Amount of stock bonds held	£6,377,391	£30,928,947

10 For more detailed and recent information see the Report of the Bradbury Committee on Municipal Savings Banks, 3014 (1928), pp. 17-21.

Another noticeable feature of the P. O. Savings Banks of the United Kingdom is the facility granted to the Penny Banks that are affiliated to it. There are 4,500 Penny Banks and the depositors are children in the small schools of the country. These secure ledgers, cash books, etc., free of cost from the Post Office as soon as these are affiliated to it. The National Savings Organisation was started in 1916 as recommended by the Parliamentary Committee on War loans for the small investors. The War Savings certificates which can be secured by paying 15*s*. 6*d*. is payable at the end of five years in £1 and this income is exempt from income-tax. These are however sold only to those whose income is below £ 300 a year and this maximum has been recently raised to £500 a year and in 1923 the price of the N. S. certificates was raised to 16*s*. and at the end of five years it is payable at £1. Twenty thousand Savings Associations have been created and a large army of voluntary workers are affiliated to the Committee.

As such multitudinous nation-wide agencies do not exist in this country, the P. O. Savings Banks should be made more popular by granting more concessions such as the withdrawal of money, say, twice a week with an interval of four days between successive withdrawals, the raising of the maximum amount of deposit money from Rs. 750 to Rs. 1,500 and the issuing of more pass books in vernacular to those who desire them are some of the means of popularising these P. O. Savings Banks. The present rate of interest was fixed long ago when the Government borrowed at three and half per cent. The Government should realise that the value of money has gone up enormously. The Government is at present borrowing at five and a half per cent. The Post Office Cash Certificates which are issued at a liberal rate of interest running practically at compound interest are undermining the popularity of the Postal Savings Banks. It is indeed bad statesmanship to pay 2½ % to the poor and middle class depositor while it pays three or four and a half or five per cent. to the richer people who lend money to it. Profiteering out of low interest of the small investor is a most unpardonable offence. This is a most undesirable source of revenue. This is the chief reason why deposits in the Indian P. O. Savings Banks have not increased along with or kept pace with the deposits of other banks. The Post Office clerks can be

deputed to attend workshops and factories on pay days and secure deposits from the wage-earners.

Every sub-treasury of the Government should be utilised as a Savings Bank and even co-operative societies can be permitted to open a current account with them.

The services of village school-masters should be requisitioned to run village postal savings banks.

More cash should be kept in the different P. O. Savings Banks to facilitate the free flow of funds.

In reality the P. O. Savings Banks are the joint-stock banks from the smallest depositors who are too poor to resort to the Jt. st. banks. Familiarising the people with cheques and other credit instruments ought to be another endeavour on the part of the P. O. Savings Banks. The Savings Banks system should be pushed energetically throughout the country by opening more Post Offices. They number at present 20,000 and most of them do not conduct savings bank business.

The deposit money should be utilised for the local needs of the district.[11] It should not be utilised as a support for the exchange situation or remitted to London for use there by the Secretary of State for India or used for meeting commercial bills or purchasing sterling in India. This cornering in the Government Treasury Chest and draining away money from beneficial uses from the provinces is an unpardonable mistake. These funds should be transferred to the Reserve Bank and made available for financing the growing requirements of our trade and industry.

[11] This is what is done in the U. S. A. The national and the state banks obtain the deposits secured through the Postal Savings Banks system. The banks pay about 2 ½ % for such deposits and 65% of the P. O. Savings Banks deposits are loaned out to the banks in the state or territory in which they have been obtained. The P. O. Savings Bank deposits are thus made to help the credit resources of the country. It is essential that this example has to be followed and if a portion of the deposits can be loaned out to the co operative bank of the districts which are requiring greater resources, a more profitable use of the deposits can be made. "Even in Belgium, France, Italy and Germany the deposits are used for municipal loans, agricultural credit and the creation of workmen's dwellings and any other safe public investment. Thus the *object everywhere else is to aid local industry and the deposit is being used for increasing wealth.* See I. Hamilton, "An Outline of Postal History and Practice," p. 56. *Italics mine.*

The Government of India have been making an organised effort to increase public interest in the sale of Post Office Cash Certificates which have often been designated as the "interest-bearing currency note." These were first issued in 1917 with the object of encouraging the investment habit on the part of the smaller investors and about eight crores of rupees were invested in this way by the end of March, 1919. With the introduction of improved rates of interest and addition of further attractions the popularity of this form of investment increased to a great extent and the official year ending in March, 1924 about 5·3 crores (net) were realised. In 1924-25 the net amount realised was about [12] Rs. 4·6 crores. With the greater propaganda work on the part of the Government it is possible to obtain greater sums which should not however be utilised to satisfy the capital requirements of the Government. A portion of the money obtained by the sale of these P. O Cash Certificates in the districts and rural areas should be set aside for use in those rural areas thus increasing the rural credit resources and help the building up of rural prosperity. The sale of the P. O- Cash Certificates is ultimately bound to give great stimulus to thrift and the systematic encouragement of this habit will have profound influence in bettering the future economic condition of the people. The sale of the Cash Certificates through village accountants and accepting them in lieu of cash as payment for land revenue would still further increase their popularity. Although further attempts in this direction of increasing their popularity can be made proper funding arrangements are long overdue and no time should be lost in making provision for this unfunded debt. No further reluction of interest yield is possible or advisable. The five-year P. O Cash

[12] It is indeed an anomaly to note that although our public debt has risen nearly to 1,000 crores of rupees no provision has been made until quite recently for the creation of a sinking fund to wipe off gradually the unproductive debt and maintain the credit position of the Government intact both at home and abroad. Sir Basil Blackett's measure is a desirable innovation. But a more perpetual, anxious and increasing effort to reduce the public debt should be made by the next finance minister. The institution of a Provincial Loans Fund for procuring necessary funds to the Provincial governments and the charging of a standard scale of interest for productive and unproductive debt are improvements in the public deb situation. The institution of a Depreciation Fund for the 5% 1929-47 and 1945-55 Rupee loans is another desirable step in the improvement of the public debt.

Certificates is the only popular form of investment available to the poorer classes. They are now sold in the denominations of Rs. 10, 20, 50, 100, 500 and 1,000 and if the investor holds the certificates till maturity the interest ranges to $5\frac{1}{2}$ % free of tax. They may be cashed at any post office. In July, 1927, this rate was still further reduced to $4\frac{1}{2}$ % free of tax. But this reduction is responsible for decrease in net receipts.[13] Owing to recent reduction of the rate of interest the purchase price yields only 3%. See table II at the end of this chapter. The total amount of cash certificates held by any person is limited to Rs. 10,000.

A small Committee should be appointed to consider the desirability of introducing the progressive model of the postal system of the countries like Austria-Hungary, Germany or the Swiss Republic. The development of the postal cheque and its possibilities should be explored.[14] Japan has introduced it.

The Government should open postal cheque offices and permit individuals after proper introduction to open an account at their office with a permanent fixed deposit of Rs. 100. This can be operated through any Post Office in the country and money transmitted to any other part of the country without limit of amount. Of course a moderate charge can be levied in this case as in that of the money order system. In a big country like India where banking is so imperfectly developed a system of this kind will make money fluid. As Mr. Darling suggests this would be of the greatest

[13] Since these lines have been written the Government have once more reduced the interest on P. O. Cash Certificates but the rates of income-tax are high and there has been a fall in value of Government securities. Undoubtedly the depositors will not fail to avail themselves of these features. For the actual amount invested in this form see the Report of the Controller of Currency, p. 18 (1934-35).

[14] Quite recently, a Committee of the Post Office Advisory Council presided over by Sir G. Lawson-Johnston considered the advisability of introducing the Postal cheque system and in order to encourage wider expansion of banking habits and secure economy of currency the offering of cheque facilities for the P. O. Savings Bank depositors was recommended. It, however, recognises that there is considerable danger in allowing the depositor the use of the cheque book. The placing of a maximum limit on the amount of the cheques that could be drawn to issue such cheques only when balances are sufficient to cover the maximum amount drawable are certain safeguards that have been recommended (see the London Times of August 2nd, 1928, p. 133).

advantage to co-operative societies to whom the transfer of money is often a matter of considerable difficulty.[15]

Instead of developing a progressive arrangement of the postal cheque the Post Office has after all devised only the use of cheques in payment of money orders in Calcutta, Bombay, Madras and other bigger commercial cities of this country. Firms and individuals who are to receive a large number of money-orders daily and are wishing to receive payment by cheques are usually paid by means of cheques by the paying post office. The acknowledgment forms of the money-orders as well as the receipt of the cheque have to be signed. Specially to avoid mistakes, the new procedure of handing over the cheques is done after the list is given to the payee and adequate time for examining the list is also afforded to the payee.

The introduction of some other desirable features must be examined by the above committee. The Indian Post Office Savings Bank must undertake to collect cheques on behalf of depositors and they may be subject to the withdrawal after the period of a week so that the P. O. would have reasonable time to collect the proceeds of the cheque. The introduction of *Small Home Safes* and the provision to open joint accounts payable to either or to the survivor would increase the available deposits that it can gather from the hands of the small savers. As in England the Savings Bank deposits of an individual debtor should not be made liable to attachment by the creditor. Indian depositors can also be given the privilege of nominating the beneficiary to whom the deposit sum can be paid on the death of the depositor.[16] This would render unnecessary the duty of investigating the rightful claimant and the survivor heir would easily secure the deposit sum with the minimum possible delay. Unless such vigorous steps are taken to popularise the P. O. Savings Banks it is quite likely to become a moribund affair as compared for example with the German Savings Banks.

15 See M. L. Darling, "Co-operation in Italy and Germany." See the Statistical Abstract for British India, 4th issue, p. 556.

16 See the Report of the Controller of Currency for the year 1927-28, p. 22. For recent figures see the annual reports of the Controller of Currency.

Table I.

Showing the Growth of Deposits in the P. O. Savings Banks.

(In lakhs of Rupees.)

Year.	No. of depositors.	Deposits (each) year (inclusive of interest	Interest.	No. of P. O Savings Banks.	Withdrawal each year.	Balance of deposits.
1915-16	1,660	816	43	10,836	773	1,532
1916-17	1,647	938	45	10,421	810	1,659
1917-18	1,637	1,016	44	10,975	1,017	15,688
1918-19	1,677	1,345	46	10,587	1,121	1,882
1919-20	1,760	1,774	56	10,670	1,522	2,134
1920-21	1,877	1,884	62	10,713	1,753	2,286
1921-22	1,958	1,772	61	10,758	1,832	2,226
1922 23	2,043	1,769	62	10,730	1.675	2,319
1923-24	2,089	1,838	67	10 535	1,679	2,478
1924-25	2,164	1,850	71	10,727	1,764	2,563
1927-28	2,606	2,400	86	12.326	2,084	3,266

Table II.

Showing the transactions on accounts of the Post Office Cash Balances.

(In lakhs of Rupees.)

Year.	Receipt.	Repayments.	Net Receipts	Outstanding at the end of the year.
1917-18	1,000	112	888	888
1918-19 & 1919-20	403	116	313	575
1920-21 & 1921-22	100	241	141	435
1922-23 & 1923-24	761	353	408	842
1924-25	610	140	470	1,312
1925-26	755	170	785	2,097
1926-27	753	172	571	2,608
1927-28	609	206	403	3,021
1933-34	1,331	523	808	6,372

List of References.

1. Annual Reports of the Director General of the Post Offices of India.

2. Annual Reports of the Post Master General, The United Kingdom.

3. I. G. I. Hamilton, "An Outline of Postal History and Practice."

4. Geoffrey Clarke, "The Post Office of India and its History."

5. Reports of the Bradbury Committee on "Municipal Savings Banks." (1928)

6. Report of Sir G. Lawson-Johnstone Committee of the British Post Office Advisory Council (1928).

7. Notes on the Postal Savings Bank Systems of England, Canada France and Italy, etc.

(National Monetary Commission Report.)

8. Reports of the Provincial Banking Enquiry Committees.

9. The Reports of the C. B. Enquiry Committee.

10. Oscar Sachse, "The Socialisation of Banking." Ch. XVIII.

11. Sidney Webb, "How to pay for the War—Fabian Society's pamphlet, Chap. on "Development of the Post Office."

CHAPTER XIV

THE CO-OPERATIVE BANKS.

The object of the chapter—Its origin—General features of the Co-operative Credit movement—The progress of the co-operative credit movement—The structure of the C. C. Societies—The present problems—How to secure improvement?—Co-operation with the I.C. organisation—The C. Bank *versus* the Joint-Stock Bank—Non-economic benefits—Slow and steady wins the race—Extension of co-operative activity in other directions than credit.

The object of the chapter.

The chief object of the chapter is to show the structural differences between a co-operative bank and a commercial bank and the different methods of procedure adopted by them. As the Report of the Government Committee on Co-operation in India shows " the same basic laws of finance govern both ordinary and co-operative banking.[1] The co-operative bank is only a miniature bank which deals with the smallest unit of saving and small questions of credit. A suitable definition which contains all the elements of a co-operative credit bank runs as follows:—It is a voluntary association of individuals with unrestricted membership and collectively-owned resources formed by small producers or wage-earners conducted on a democratic basis by accumulating the savings of the members and granting them credit on easy terms of interest and repayment, surplus being placed to reserve or distributed between depositors, borrowers and shareholders, the association also using the joint responsibility of its member as a security for loans obtained for its members from outside sources.[2] It brings cheap money to the door of the borrower and increases the volume of available credit. In this light it is considered as a huge borrowing machine whose main interest is to lower the rates of interest and promote the welfare of the country by encouraging thrift and self-help among the members. Borrowing at the *right* time for the

1 The Maclagan Committee's Report on Co-operation in India, 1915, pp 65-70.

2 See N. Barou, Co-operative Banking, p. 78.

right amount and for *right* ends and repaying it at the *right* dates are the objectives of the co-operative credit movement.

The origin of the Co-operative credit movement.

Co-operative banking in India is in its infancy. Sir Henry Stork first conceived the idea of starting the co-operative movement in India. This was no doubt due to the initiative which other countries were showing in this matter. Leon Say in Belgium, Leonne Wollemberg in Italy and Prof. Tanviray of France were the pioneers of this movement in their native countries, but little headway could be made in this country against popular apathy. The late Sir Frederic Nicholson was commissioned in 1892 to study the agricultural banking organisation of other countries and he recommended the Raiffeisin type as the suitable one to alleviate the sufferings of the Madras agriculturists. H. Dupernex[3] was doing spade work in the matter of the People's Bank in the United Provinces. It was Lord Curzon, who was really anxious to increase the well-being of the people, who appointed a committee to consider the feasibility of introducing the Raiffeisin system of co-operative organisation. The Famine Commission of 1901 urged the importance of starting mutual credit associations. The Co-operative Credit Societies Act was passed in 1904 to encourage thrift, self-help and co-operation among agriculturists, artisans and persons of limited means. But there was no provision made in this Act to create central societies for supervising and financing the primary, rural and urban societies and legal protection was not extended to co-operative societies, organised for other purposes than credit. The remodelling of the Act in 1912 gave scope to remedy the above defects observed in the course of its working during the previous half-dozen years. The Co-operative Societies Act of 1912 conferred legal status on co-operative societies organised for marketing, production and insurance. Scope was given to the people for creating a central organisation. The old-fashioned distinction between urban and rural was given up and the classification of limited and unlimited liability was introduced in its place. Subsequently the different provinces have enacted different Co-operative Societies Acts to cope with special

[3] See H. Dupernex, The Village Banks, pp. 8-11.

problems of their own. The Provincial Acts of 1925, 1927 and 1931 passed in Bombay, Burma and Madras have consolidated the position of the co-operative movement in the respective provinces.

General Features of the Movement.

To-day, there are a great variety of types among the credit societies. The money doles extended by the Government in the early stages of these societies have been discontinued. In the matter of credit supervision, training and propaganda non-official support is being actively enlisted. But as it is, the present co-operative movement has not been sufficiently deofficialised. The Registrar and the staff of the co-operative department constitute the administrative side of the movement and perform the inspection business. The Provincial co-operative banks and the District Banks constitute the financing machinery of the primary co-operative societies or units. The Provincial and District Federations of non-official men, the unions and institutes form the propaganda body and co-operative education is diffused through these channels. Supervision and propaganda constitute their regular business. The progress of the co-operative movement depends on the proper functioning of these three distinct organisations.

The Progress of the Movement.

More societies are arising. Members are increasing. The capital of societies is fast increasing and though a crisis in one province or a failure in other places may occur the movement is having a healthy growth and real progress is being achieved in several directions. The following table gives the readers an idea of the gradual growth of the co-operative societies.

Capital is increasing faster than membership, being now nearly Rs. 199 per member and the average membership per society is now 39. The capital is Rs. 7,628 per society.[4] India has the largest number of co-operative societies amongst the countries of the world but their strength is very insignificant. The following table shows the

[4] See the Annual Report on the Progress of the Co-operative Movement, 1926-27.

membership, population and strength of the co-operative societies of the world.

Country.	Total Popn. in mills.	Total No. of Societies.	Total Popn. per Society	Total membership in Co-operative Society.	Total Popn for member.
India ...	352	106,050	3,319	4,294,339	82
Japan ...	64	15,079	4,266	4,700,208	14
China ...	452	2,515	179,721	79,114	5,721
Great Britain ...	46	4,084	11,500	8,367,730	5·5
Germany ...	62	52,030	1,192	9,513,719	6·5
France ...	41	35,366	1,171	5,368,919	7·5
Denmark ...	3·5	6,988	500	956,989	4
Australia ...	5	1,088	5,000	327,122	17
Canada ...	122	31,078	3,936	16,411,181	8

While the above table speaks of the growth of the co-operative societies of all kinds the following table shows that there is progress in the growth of non-agricultural societies, the Central Banks and the guaranteeing unions as well.

	Average ending from 1915-16 to 1919-20.	Average ending from 1919-20 to 1920-25.	Average ending from 1925-26.	Average ending from 1926-27.
1. Central (including Provincial Central Bank and Banking Union)	404	508	567	577
2. Supervision and guaranteeing union ...	638	1,302	1,406	1,421
3. Agriculture (including cattle and insurance societies) ...	25,873	5,116	71,140	78,940
4. Non-agricultural	1,662	4,183	7,069	8,133

As the above table speaks of all-India progress a bird's-eye view of the development of co-operative societies in the different Provinces would be necessary. The following table shows the growth of the co-operative credit movement in the provinces :—

Provinces.	Popn. in.	Total No. of Societies	No. of Societies per 100 inhabitants.	Total No. of members of primary societies.	No. of mems. of primary societies per 1000 people.	Total working capital in crores of Rs.	No. of services per head of pop.
Madras ...	46·7	13,581	29·1	883,100	18·9	16·19	55
Bombay ..	21·9	5,816	26·1	587,649	26·8	16·17	118
Bengal ...	50·1	23,538	47·0	777,809	15·5	17·66	56
Bihar and Orissa	37·7	8,901	23·6	25,680	6·8	5·75	24
U. P. ...	48·4	6,051	12·5	152,930	3·2	2·24	7
Punjab ...	23·6	21,395	90·7	707,689	30·0	18·47	125
Burma ...	13·1	2,167	16·5	12,267	5·5	2·32	28
C. P. and Berar...	15·5	3,794	24·5	71,934	4·6	5·57	57
Assam ...	3·6	1,400	16·3	64,338	7·5	0·[illegible]6	16
N. W. F. P. ...	2·4	451	18·8	15,338	6·4	0·19	13

The co-operative credit movement is clearly making rapid financial progress. The financial resources of the co-operative credit societies are becoming stronger than before. There is steady increase of the working capital of the banks. Unlimited liability with share capital has proved a distinct success. Although loans from the Central Banks bulk largely in the matter of agricultural societies deposits from members are slowly increasing. The Reserve fund is increasing and a judicious use of it is being made. Loans to members for distinctly productive and unproductive purposes are [5] granted at rates of interest ranging from 9 per cent. to 15 per cent. and the repayment of these loans by means of instalment has proved a benefit to the borrowers. If the membership of the Agricultural societies is taken into account they belong to all classes of society. Landlords, tenants

[5] This is best defined by the Maclagan Committee itself : " Unproductive loans are for inevitable expenditure and not excessive in amount. The contracting of such loans is the weak spot in the agricultural economy of the Indian peasant."

and labourers are generally members of these societies. The Post Office in which the funds of the co-operative credit societies are deposited has devised improved means to liberate these funds as quickly as they are required by the societies. Sometimes well-to-do members to whom is entrusted the fund have been won over to the cause of the co-operative movement. Thus a good solution has been devised for the safe custody of the funds of the primary co-operative society. The local management of the co-operative credit society usually rests in the hands of the *Punchayet* or managing committee consisting of elected officials working gratuitously and the business consists in looking after applications for loans, settling problems of admission and expulsion of members, receiving deposits, collecting overdue loans, checking accounts and allotting money for the working expenses of the society.

The structure of the C. C. Societies.

These individual and completely independent village societies as they are styled in co-operative literature are federated into unions or central societies for securing finance and proper control. Unions formed solely for continuous supervision purposes are simply designated unions or supervising [6] and audit unions. The function of *guaranteeing* unions is to supervise and guarantee the security of the societies affiliated to it.[7] They maintain a rotation register, revise property statements, and keep a register of delegates of primary societies. The supervising body of the union has to inspect the financial position of the societies and recommend loans to be made by the Central or District Bank. Just as the financial side of the co-operative movement is organised on a proper basis so also for the educational and propaganda business there is a well-knit organisation of which the supervising or guaranteeing union consists usually of twenty to thirty societies or more. They are organised into federations and these have their apex organisations in the Provincial Co-operative

[6] In Bombay they are very popular and help the Central Banks in their financing operations.

[7] The Province of Burma was the first to create this type of organisation. The Maclagan Committee recommended its adoption by the other provinces. Except the Central provinces other provinces have adopted this suggestion.

Union. The duty of this federation is to formulate a right educational policy and see that the unions carry it out in right earnest. They are the real agencies which are to introduce supervision, propaganda and education and help the position of the financing banks to a great extent by enabling the people to understand the true spirit of the co-operative movement. If the function of procuring finance is also attached to other duties of the union it is styled the Banking union. But if a central society exists purely for securing finance for the constituent members it is designated a Central Bank.

The Central Bank of the mixed type [8] where individuals as well as primary co-operative societies can become members has been accepted as a suitable form of organisation and unlike the European Central Banks which act as a mechanism for balancing funds the primary duty of the Indian counterpart is to secure more funds to the individual Co-operative Banks. In addition to this the inspection of affiliated societies is also taken up by the supervisors appointed for this purpose so that they can check the decline and fall of primary societies which have borrowed from it. This administrative action of the Central Banks is bound to be useful to the movement for it enables the Central Banks to occasionally inspect the financial position of the primary societies and instead of placing reliance only on their unlimited liability feature they can better gauge their ability and prevent them from drifting into chaos. This becomes inevitable when the supervising unions and the federations do not discharge their work of supervision on correct lines. The Central Bank should never be considered as an outside agency having no moral claim even to dictate terms and supervise the primary societies. The primary societies, the Central Banks and the Provincial Apex Bank really form an integral feature of the co-operative credit movement. The Central Bank is a federation of the primary societies where they form a decisive power of fixing the volume and period of payment of loans to the

[8] The main reason why pure type banks consisting solely of the primary societies cannot be recommended is that adequate talents cannot be enrolled for managing the primary societies and the neglect of the support which the enthusiastic non-official people are willing to render would be a sheer unpardonable mistake. The danger is that they might become pure monetary banks without the expert guidance of bankers.

primary rates of interest to be charged on the loans and all other details. They are all fellow pilgrims in search of a common end and are actuated solely with the motive of acting " each for each " and " all for one." Providing the bulk of the capital to the primary societies the Central Bank has to watch over the safe employment of this capital and enforce the recovery of the same from the borrowing societies. The right of inspection and enquiry has already been granted to the Central Bank in the Madras Presidency and even the supervising unions do this work. It is advisable that this staff of the supervising union should be controlled by the Central Banks. The divorce of supervision from finance and the theory of autonomy of the co-operative units as advocated by Wolff cannot be considered suitable to Indian Co-operative conditions. Superimposed on the different Central Banks is the properly constituted apex Provincial Bank [9] and its recognised duties are to lend through the Central Banks and invest the surplus funds of the Central Bank and deal with the primary village societies through the Central Bank alone. It also acts as the channel of inter-communication between the co-operative movement and the Imperial and the joint-stock banks.[10]

Its sole business is " to forecast and arrange for the provincial requirements as a whole and be the financial co-operative centre for the province," says the MacLagan Report.

A bird's eye view of the co-operative financial structure has been given and it would not be complete if the relations between the provincial banks and the money market are not outlined. It has clearly been stated that the cash credit system of lending to the apex Provincial Bank is approved by the Imperial Bank of India. Other joint-stock banks also lend on the cash credit basis or grant loans for a specific period to the District Central Banks.

9 The Bombay Provincial Co-operative Bank has started a network of branches in the province to conduct its financial operations. It is feared that such a step would make it too commercial in character and the truly co-operative character of the organisation would be forgotten. So long as the right to grant loans is not abused and the borrowed money is not pressed in non-productive directions it is unwise to level the charge of commercialisation against it.

10 See the Report of the Maclagan Committee on Co-operation, p. 59.

The Present Problems.

Initially organised by the state the co-operative idea has received a wide extension and the present problem is the gradual diverting of the duty of the state in matters of organisation, management and supervision and handing them over to the popular control of the federation of the co-operative societies without endangering their stability, minimising their popularity, undermining popular confidence and reducing the efficiency of the co-operative societies. A gradual transference of duties of organisation and supervision to the requisite knowledge, enthusiasm, time and driving power must be accepted as the only available solution. At present an absolute demarcation of work between the official department of co-operation and the honorary non-official apex co-operative organisation is essential and as the work of the latter bodies proceeds on a satisfactory basis more functions should be entrusted to them. It is these non-official organisations that ought to initiate and organise co-operative work in all directions and the future role of the Registrar should dwindle to that of a mere expert adviser as a guide, philosopher and friend. Periodical Government audit should continue and the primary societies should continue to pay for the annual audit. The other Government Departments such as the Agricultural and Industrial should co-operate with the Co-operative Department. The granting of free technical advice to non-credit societies should continue.

While the broad principles of the co-operative structures have been stated it may without exaggeration be said that it has not evolved a systematic and definite policy of its own. The co-operative mind is still oscillating between the long-term and short-term loans.[11] Except in Burma where the problem has been tackied [12] successfully and a brand new co-operative organisation for the granting of long-term credit by the National Mortgage Societies is shortly to be created (March 31, 1928), the other provinces are still striving to

[11] The Royal Commission on Agriculture has done signal service in recommending a complete separation between the two lines of credit.

[12] See the Burma National Co-operative Mortgage Bill for instituting long-term credit facilities for the peasant proprietors.

combine limited long-term loaning [13] business with short-term loaning business. The problem of securing adequate financial help in those provinces where the co-operative credit system has not obtained enough working capital has not been satisfactorily solved as yet.[14] Some of the Provinces like the U. P. have not created the Provincial Co-operative Apex Bank as yet. It is only quite recently that the apex Co-operative Bank of Bangalore was started as the Central Financing Agency of the Co-operative movement in the state of Mysore. The problem of obtaining access to the money market to permit the provincial banks to unload their seasonal surplus or to borrow funds by rediscounting their paper has yet to be solved. It must be remembered that the C. C. movement finances only a small portion of the needs of the primary agriculturists. Even in the Punjab where it is more fully developed 40 to 60 per cent. of the numbers have secured loans from outside. If the C. C. movement has to supplant this outside financing agency more funds would be needed.

The system of securing cash credits and overdrafts from the hands of the Imperial Bank or the other joint-stock banks is only a useful palliative. The recent decision on its part to curtail overdraft arrangements has to be remembered. Loans from Provincial Banks to each other would be better method than reliance on the Imperial Bank. Acting as a competing bank it would be more and more censorious in the matter of co-operative paper offered as collateral security. The establishment of the R. Bank would undoubtedly enable them to use eligible co-operative paper to secure additional financial resources.

The starting of an All-India Co-operative Bank would be unnecessary in the light of new developments that have taken place during the last decade and progress in no province should be hindered for the sake of dull uniformity and for allowing the backward provinces time to level themselves up to the position of the more forward

13 The Naogan Ganja Mahal Co-operative Bank, Ltd., which is the only mortgage bank conducts both short-term as well as long-term business. In Bombay the attempt is to institute a separate department for long-term credit needs and that the provincial Co-operative Bank should take up the financing of land mortgage banks operating in these areas.

14 Deposits form 10·15 per cent. of the working capital of the Indian Co-operative Credit Societies. In other countries the proportion is decidedly higher often running up to 80 per cent. of the total working capital.

provinces. The holding of joint conferences annually and co-ordinating the efforts of officials and non-officials, the formation of an All-India Co-operative Union to improve the co-operative backwardness of India by consolidation and the federation of the existing co-operative societies, the subject of co-operative education, the important issue of the future attitude of the Government towards the co-operative movement, the problem of relieving the overburdened Registrars, the training of the co-operative personnel in the law and the principles of co-operation and the evolving of the proper business methods on sound financial lines have not been satisfactorily dealt with and an effective solution of these problems would improve the organisation, increase the momentum of the co-operative movement in India and will bring India into line with the other progressive countries of the co-operative world. The real problem of the C. C. movement is to secure extensive and unlimited financial facilities at the top and to see that they are used at the bottom on sure, safe and sound lines.

How to improve the C. C. Societies ?

But the realisation of the above programme depends on the improved working of each financial unit of the co-operative system beginning from the village society up to the apex Provincial Co-operative Bank. The primary village co-operative society must pay more attention towards attracting voluntary deposits and the consolidation of the village banks as these form the very foundation of the co-operative system. The method of attracting and encouraging voluntary deposits from members adopted in Japan can be copied wholesale in our country.[15] The officials and employees of the co-operative credit society visit each house and collect deposits. "Members take it in turn to collect. Collecting boxes are provided by the society. Savings clubs are organised and on the savings days deposits are taken simultaneously by the members. A part of the proceeds of the sale of property is deposited as a compulsory thing. There are some economists who point out that compulsory purchase of shares do not represent real thrift but it would augment the loanable resources. To

encourage deposits societies may grant high rates of interest on greater deposits or offer money rewards. The pass book is granted to families to save in favour of children. A portion of the harvest is collected and converted into deposits. Encouragement of subsidiary industries as bee-keeping, breeding silk worms, etc., has also been given. All dividends are converted into deposits. Lectures on thrift are delivered and thrift songs specially composed in a popular style are sung by members. Unless the working capital increases the general shortage of money would be felt and it would be difficult to cope with the demand from the different societies. But when we take the characteristics of the Indian agriculturists into account it becomes easily apparent that the matter of gathering deposits is not an easy task. The ryot distrusts banking and the maintenance of capital. His only object is to invest his all on land. He does not even shrink from borrowing to purchase his land. Land and real estate form his desirable assets and he prefers to borrow on this security. A banking population on the other hand would draw a cheque on its balance. So long as this psychology exists unchanged it is difficult to create the banking habit in the minds of the Indian ryot.

The practice of receiving interest alone regularly on the loan instead of insisting on the payment of the full loan has to be checked. Short-term loans must not be allowed to become long-term loans in practice, for long-term loans generally become arrears. The granting of loans to men comfortably situated in life so that it might be advanced in small sums to others at high rates of interest is the reverse of co-operation and has to be discountenanced. Proper steps must be immediately taken without fail to collect loans if they are supplied by borrowers. Regular holdings of monthly meetings, prompt entry of all transactions in records, the maintenance of fluid reserve in case deposit banking is pursued and repayment of loans in due time must be secured and encouraged. All these transactions must be conducted on well-known business principles. The borrowing capacity of these primary societies must not be exceeded. Money should be granted to borrowers on standing crops up to 50 per cent. and harvested crops up to 80 per cent. and gold or jewellery can also be considered as suitable supplementary collaterals. The maximum borrowing power of each individual member should not be exceeded. The economic purpose of the

loans should be carefully studied or scrutinised. Loans to borrowers should be secured from the Central Banks alone. Resort to local money-lenders or sowcars should on no account be allowed. To relieve the excessive dependence on the Central Banks the primary societies should be started with a share capital basis payable in annual instalments and a Reserve Fund has also to be distributed to members promptly and the forecasts of primary societies' needs can be sent to Central Banks who can make prompt provision for the making up of these loans. The village primary societies must be allowed to open current accounts in urban banks and allowed to draw upon them by cheques. This would achieve a dual purpose. Firstly, cheques would become more popular as the retention of cash in the hands of office-bearers gives scope to fraud, misappropriation or any other defects such as the abovementioned ones can be safely remedied by the above method. The village societies would do well to imitate the money-lender's service and like him combine other lines of useful activity to help the borrowers. Without unduly sacrificing the financial aspect of its business it can act as a "general purpose society,"[16] instead of being purely a credit society alone standing in isolation even though no co-operative sale or purchase society is operating in the place. As India is mainly an agricultural country more credit societies of the Raffeisin type should prevail with suitable modifications to suit the conditions of the different provinces. The Schulze Delitzch form of urban credit should be adopted on a wider scale. It is not the expansion of co-operative credit societies alone that is required but the co-operative current must be directed in other channels such as marketing, purchasing, building purposes and production directions and for the improvement of the backward or the depressed classes and the Criminal Tribe Settlements. Without such parallel efforts in other directions more credit societies alone cannot hope to make the village people better men, better farmers and better citizens and secure an improvement in their standard of living. Above all the periodical examination of the assets of the primary societies has

[16] The Royal Commission on Agriculture however recommends the single purpose society alone. But in the absence of adequately educated people in the village no real progress can be achieved if the co-operative movement is not used to increase the economic progress of the village.

to be done mainly with an eye to secure rapid improvement in their progress. The property statement of the societies should be kept up to date. Dishonest office-bearers should be promptly removed by the societies. There should be no undue leniency in the matter of collection of loans from defaulters.

Suggestions for improving the Central Bank.

The Central Banks must take up the current accounts of local individuals, traders, and businessmen and with their properly trained office-bearers undertake to spread banking facilities in the interior. They must develop into complete self-governing local bodies and not degenerate into mere branches of the apex Provincial Co-operative Bank. They must in turn pay proper attention to the village primary societies and should not consider them as mere channels for distributing their credit and kill all initiative, individuality and real spirit of co-operation in the village societies. They must be arising out of the necessity of the primary societies for centralisation and must tend towards cementing their growth and organisation. Though the absence of propagandist bodies is forcing the Central Banks to confine their attention to propaganda, organisation, education and supervision of societies yet they should realise that a "central bank is, when all has been got ship-shape, to serve, not to be tutor to the local banks." It is in fact designed to be a bank. Their main duty is to finance and nourish properly the different village societies. They must tap local capital for local use. The issuing of more thrift certificates to members as well as non-members would tend to the increase of long-term deposits lying in their hands. No limit should be placed on the deposits of non-members who generally have no access to any other banking institution. So long as a large staff for organisation, supervision and control of the societies is not available the Central Banks would have to do this work to improve the quality of the primary co-operative societies. In the absence of broad-minded education, advanced outlook and experience of the outer world on the part of the generality of the people dependence on trained staff is necessary. Expert executives and business directorates are essential in the absence of general intelligence and business instincts.

Co-operative Bank directors and honorary organisers should take their responsibilities more seriously and exercise them more selflessly. It is high time to realise this higher and nobler conception of their duty. Much time is wasted in securing loans as the applications of the individual borrowers have to be passed by the Central Bank which has to provide the necessary finance when the village societies lack the necessary funds. The distribution of the Central Banks' loan is often made to those who do not immediately stand in need of it at that particular time. There should be real co-operation between the Central Banks and the guaranteeing unions of federations in the maintenance of a trained staff which can be utilised in the matter of inspection or supervision. The Central Banks should forsake all anti-co-operation spirit and instead of conducting business on joint-stock principles should realise the true spirit of co-operation. Some of the Central Banks in Madras have too large an amount of deposits to be safely loaned out to borrowers and the anxiety to pay the depositors is forcing them to make unco-operative investment of the same fund in the money markets of the country.

The idle balances of the Central Banks should be passed on to the P. Apex Bank which can make a business use and investment of the same. It is folly to refuse taking further deposits on the plea of idle balances. It is far more advisable to lower the rate of interest simply and hand them over to the P. Banks for a safe use of funds and return of the same. Another vicious practice that has to be strongly condemned is the refusal to grant loans to primary societies on the score of their overdues. The net result of this action is forcing even the credit-worthy members of the primary societies to the arms of the money-lender.

The co-operative urban banks should not depend on honorary or low-paid agency as before. Employing specially trained staff they should take up all services of a banking nature beyond the one of receiving deposits and making loans. A provincial co-operative urban bank would help the scattered and different urban banks within the Presidency. These urban banks or people's banks would tend to retain the savings within the towns and develop agriculture, trade, industry and arts. They can cheapen "remittance business by popularising cheques, demand drafts and hundis." Organised on a limited liability basis and consisting of people of all castes and creeds

these urban banks can render effective aid in organising banking facilities in all places where the big joint-stock banks are conspicuous by their absence. Both in Germany, Switzerland, Bulgaria, France and Italy these people's banks are flourishing institutions. As the rapid future extension of capitalistic banking cannot be secured India should concentrate its best energies in developing more efficiently managed urban banks and tend to provide for their effective supervision by the Provincial Co-operative Bank. Unless these develop the fight against the money-lenders they would not succeed. Liefman truly observes that "co-operative credit organisations are fighting organisations." They are institutions of self-help against exploitation of the money-lender. The success of these urban banks lies in not pursuing a too limited policy and keeping too large liquid resources nor in pursuing a too venturesome policy which consists in granting loans on doubtful security for undefined periods.

The provincial co-operative apex bank must act as a link between the co-operative financial system, the money market and the state. Interlending between the provincial apex banks has to be encouraged and further mutual assistance in the direction of purchasing or selling securities has to be developed. Their working and business methods must be improved greatly. More facilities from the Imperial Bank in the matter of internal remittance must be obtained. They are to act as the guide, friend and philosopher for the different Central Banks. Their loans to the Central Banks must be made for productive purposes and preference must be given to produce loans or crop loans instead of loans for redemption of existing indebtedness or for enabling the agriculturists to make large-scale agricultural improvements. These form the main duty of the mortgage banks and no confusion ought to exist between the two types of banks. Both the Central as well as the Provincial Banks can grant loans on the security of depositors. The present centralised organisation of the co-operative system is good provided it does not become commercialised or officialised or top-heavy and unnecessary duplication of efforts and consequent waste of energy is avoided. The guaranteeing union, the Central Bank, the district Federations and the provincial co-operative unions can, with some more experience, increase the efficiency of the weak and incomplete federated structures and other countries would do well

to learn this feature of coherent organisation from our country. For the present there are no serious fissures in the co-operative fabric. While in other countries, notably Germany, there is no real union of agricultural and urban co-operative organisations India has from the beginning been blessed with real union and all co-operative societies are attached to the same federation or union and there is a nation-wide organisation devoid of any separatist tendencies. If mutual lending between the apex provincial co-operative banks becomes a settled fact there would be great advantage of this procedure. Any excessive investment of their funds in Government securities would tend to withdraw financial facilities available for agriculture. Co-operative money should not be unduly converted into Government purposes. As in the Italian and Dutch co-operative systems political and religious rivalry does not mar the utility of our co-operative banks. Religious or communal strife should never be introduced in the co-operative movement at any cost or else the tragedy of the Italian Co-operative movement would be enacted in this country.

State spoon-feeding has been rightly given up. If the deposit-attracting function becomes a settled fact there would be an accumulation of savings. A high standard of fluid resources must be maintained by provincial as well as Central Banks. Educational propaganda is needed in this direction. The Central Bank of Issue of this country should not fight shy in financing the Provincial Banks thus establishing a link with the rural credit system of the country. Government audit, supervision and control which are outlined in Sections 35 and 36 of the C. S. Act must continue till expert non-official executives can be secured. The undertaking of arbitration and liquidation of societies should be performed as usual by the Government Department.

Co-operate with the International Co-operative Organisation.

Such and other present-day problems facing the co-operative movement have to be solved tactfully. The prophecy that the co-operative movement is bound to become a permanent asset of immense value to India would become a realisation one day or other. It would enable the co-operative system of the country to

take its due position in the International Banking System.[17] Separatist economic tendencies and political difficulties stand in the way of the realisation of the ideal dream. A great degree of international co-operation is wanted to make this scheme a success. The idea for the present is as vague and nebulous as the proposal for the starting of an International Bank which can afford to issue a legalised international means of payment having a stable relation to gold. The International Co-operative Alliance is undoubtedly doing much spade work in this direction and the future development of co-operation in all countries must be on lines chalked out by this international body. Such a wise measure which is recommended by the Twelfth International Congress held at Stockholm in 1927 as the co-ordinated working of the exchange and trading relations between agricultural and consumer's co-operative societies is bound to be accepted in all countries. Collaboration of the co-operative banks, agricultural co-operative societies and consumer's co-operative societies in the common endeavour of solving the problems of the rural societies is bound to be of great benefit and a united community based on mutual self-help would be formed.

The Co-operative Credit Society versus *the Joint-stock Bank.*

It is imperative at this stage to recognise the vast difference that exists between a co-operative banking institution and the commercial bank. The business of the commercial bank is to create credit and place it in the hands of the deserving people of the community. It acts as an intermediary between the lenders of money and the borrowers. It collects small savings and turns this broad stream to fertilise and irrigate the channels of industry and commerce. It grants loans on the strength of adequate security entrusted to its hands. Occasionally it permits people of undoubted personal security to overdraw their account now and then for a short time. It discounts bills of exchange arising during the course of trading transactions and by purchasing the trade bills it grants the needed money to finance trade. This, briefly speaking, is the work of the commer-

17 For the advantages of the I. C. Bank see N. Barou, Co-operative Banking, pp. 323-26.

cial bank which is familiar to everybody. It brings prosperity to all parties concerned in the matter. But unfortunately it makes the rich richer. It in no way benefits the poor man and does not uplift him to a higher place in the society. Only a few fortunate rich can satisfy the exacting requirements of a commercial bank in the matter of security. But the poor by virtue of their poverty are handicapped. It is here that the co-operative bank comes up to fill the gap. The co-operative bank is the poor man's banker, *i.e.*, people's bank as learned writers put it. Its main duty is to democratise credit and place it in the hands of the poor agriculturists, small artisans, small traders and thrifty consumers. While the commercial banks drain away the deposits from the rural areas to big cities the co-operative bank tries to stem the tide and induce the return of the deposit money from the cities to rural areas. Though they may be entitled to credit they scarcely get any recognition at the hands of the commercial bank.

The co-operative bank acts not only as an intermediary between the lender and the borrower of money but it tries to inculcate principles of thrift. In the very process of obtaining credit from the co-operative bank there is scope for education. As M. P. Francois has written " the co-operative banks democratise credit, relieve distress, create wealth and turn to good account industrial and agricultural opportunities." The hitherto isolated people learn the value and powers of association. In the very methods of providing credit the co-operative bank teaches the lessons of self and mutual help and suggest the extension of these to outside matters other than credit. It thereby promotes insensibly their own self-development. Already we notice a humble start being made in the direction of sale and purchase societies to benefit the agricultural people and town-dwellers. In the matter of financing cottage industries and the building of houses the co-operative movement has been enlisted and bids fair to pervade every activity of our social life.

If the spiritual, moral, intellectual and economic progress of the rural population has to be secured it can only be done by extending the real spirit of co-operative organisation in the field of education and industry. The co-operative organisation must not be understood as purely a strict business organisation caring solely for the pecuniary advantage of its members. This objective has to be transferred into

one of common productive enterprise. The co-operative organisation must be understood as a fully "socialised method of organising the economic and cultural life of different groups of societies." In the production and sale of agricultural products the purchase of implements, raw materials and manure, the furtherance of irrigation projects, the consolidation of agricultural holdings, the insuring against agricultural risks, the opening of dispensaries and schools, the improvement of live-stock, the construction of new roads and the combined bargaining for reduced railway freights, the cementing bond of co-operation would be an invaluable boon. It is in the Province of the Punjab we find agricultural non-credit co-operative societies flourishing. This is no doubt due to the remarkable work of the Punjab Economic Board of Rural Enquiry. In a model co-operative village in Kashmir the co-operative movement is in full swing. Credit, sanitation, education and consolidation of holdings are looked after by co-operative societies and every village is a member of these societies. The enlightened Ruler of Kashmir has remitted a quarter of the annual revenue of the village in appreciation of work and further incentive in this direction. The novel experiment of allotting land to middle class families for agricultural purposes is also being tried in the Province of Bengal. But co-operative research stations, post-offices and hospitals can be started as has been done by the Dutch people. Co-operative labour societies, so peculiar to Italy, can also be started among the permanently settled labourers of the industrial areas to mitigate the influence of the building contractors, ex-middlemen and sardars who undertake to recruit labour for factories and big employers. Similarly, municipalities can encourage them by employing them in road-making, bridge-making and drainage schemes, if any such exist.

The commercial bank is a joint-stock bank where the expert manager or the managing director plays an all-important part and the shareholders are sleeping partners. On the other hand, the co-operative bank resembles a piece of active machinery in which every spring, every wire is alive and knows and consciously performs its duties being endowed with the capacities of rendering discriminatory services according to the merits of each case watching and checking the other parts. There is common control, wide publicity and efficient supervision in the co-operative bank. There is a sense of responsibility in the minds of each member. There is discrimination in the selection

of loans. Utmost vigilance is exerted in the control of their employment. Thus there is much of self-education in this case. The co-operative bank has certainty of custom and a well-known market. The quality of customers is all that is desired because " the customers have passed through the sieve of selection and having been tried and approved are held fast by the powerful bond of joint-stock interest and common liability." The commercial bank has no such advantage.

The co-operative bank operates with small working capital and insists on prompt and easy payments. It succeeds in turning over its money with comparative rapidity. The co-operative bank takes special safeguards to protect itself against bad debts. They are the linking up of the liability of all and the insisting of the productive use of money that is lent. The co-operative bank is near and familiar and the commercial bank is distant and unfamiliar to its customers.

The co-operative bank is a successful tapper of savings. It affords a better rate of interest to the people. There is more remunerative employment of its fund than in the case of the Government Post Office Savings Bank. These are subordinate to the Government. Like the co-operative bank the savings banks do not educate and train savers to independence and enable them to obtain business knowledge and promote self-reliance on their part. " It is not self-government that can be obtained in the matter of savings banks." A co-operative bank is the depositor's own bank hence " the money may be profitably employed in setting up workmen's dwellings, in settling small folk on land and money is made to fructify in productive employment." Savings banks are less personal than the co-operative banks and do more valuable service in the matter of their promotion.

Complementary Institutions.

There is no antagonism between the different types of banks, one seeking to destroy the other or planning for the downfall of its rival. There is place for both these kinds of institutions in a well-organised credit system. The commercial bank holds the cash box of the market and has full control over the money market. The co-operative bank does not exist to dethrone them from this position. They wish to play a less humble role as " collecting banks "; not as

rivals but as " feeders" endowing small people with moderate capital and train them to banking habits and prepare them for business with more capitalist institutions to which they are likely to go as they become wealthy. They educate and train the people towards habits of thrift and draw money out of hoards. The final end and aim of the co-operative movement is " the production of fine human beings and not the production of rich goods." [18] This is the philosophy of co-operative banking. While such are the idealistic aims of the true co-operators who are guiding the co-operative movement it would be interesting to note how far these ideas have been realised in our country.

Economic Benefits.

Something has been done in reducing the rate of interest at which the agriculturist can borrow and the following table shows the rates of interest at which the agriculturist could borrow in the different provinces in 1926-1927 :—

	Provincial Bank.		Central Bank.		Primary Societies.	
Name of the Province	On borrowing.	On lending.	On borrowing.	On lending.	On borrowing.	On lending.
Madras	...	...	2 to 7½	7 to 8½	7½ to 8½	9⅜ to 10
Bombay ...	2-6½	6½-8	7-7¼	8	6⅓	9⅝
Bengal ...	3½-7	7-7½	2-9	3-16¼	9⅜	15-5-3
Bihar and Orissa	5-6	7	8	12⅓	12½	15-5 8
Punjab ...	6	7	7	9	9	12½
Burma ...	7	10	9	10	10	15
C. P. and Berar ...	2-7½	7-8	4-7½	9-12	10	12-15
Assam ...	4-7	8-11	6¼-8½	11	...	...
U. P. ...	No P.B.	No C.B.	7	12	12	15

(For present-day rates see the Administration reports of the various provinces.)

[18] See Alfred Marshall's address at the Co-operative Congress, Ipswich. Not one of the cherished ideals can be realised if the true spirit of co-operation is not understood. Co-operation is the real basis of human action and real co-operation cannot be assured if an overwhelming sentiment permitting joint action cannot be engendered by means of liberal ideas which seek to realise the common interests and the common good of all.

The saving of interest in this direction is one tangible economic result arising out of the co-operative credit movement. The local rates of interest have everywhere been reduced as a result of competition between the money-lenders and the co-operative societies. The habit of saving has been improved to a certain extent and the increase of share capital and the deposits speak eloquently of the impetus imparted to the people in the habit of saving. But the real reason why greater deposits in village societies are not forthcoming is the high rate of interest that can be secured by private money-lending. Even co-operators obtain loans from the credit society and redistribute the same in lucrative investments in the field of private money-lending for unproductive purposes.

Another great advantage of the co-operative banks is that they attract deposits which are of " lying character." As Mr. N. D. Beatson Bell points out " the co-operative Banks have weathered the crisis when the greatest War in history began and they have weathered many a storm already and in spite of these trials the co-operative credit movement is going strong." The late Mr. J. M. Mitra says that "while withdrawals from P. O. Savings banks were fairly large and although there was a run on the Indian Jt. St. banks there was hardly any rush on the co-operative banks for deposits and this means that the public has a good deal of confidence in the movement." It is these banks that can best tackle the hoarding propensity of the agriculturists. The employment of systematic collectors or "home-booes" to tempt people to put money in them would lead to the formation of the deposit habit. These methods have been tried with success in America and adopted in Japan and are bound to succeed in our country also. The co-operative banks are already acting as compulsory savings agencies after the harvest time. This practice should be stimulated and when once the agriculturist is broken to thrift there is prosperity in store for him.

Although the ratio of co-operative funds (capital, reserves and deposits) to the total working capital of the movement is steadily increasing it is not so high as in the case of other countries.[19]

[19] The Naogaon Ganja Cultivation Co-operative Society spent in 1925-26 Rs 9,300 on maintaining three medical dispensaries and one veterinary dispensary in addition to defraying the cost of buildings, and Rs. 10,000 towards the cost of the primary and secondary schools.

Table showing the ratio (1925).

Country.	Urban.	Rural.
India	19·0	13 0
Austria	4·4	...
Germany	20·5	11·4
Czechoslovakia	4·0	1 5
Italy	7·1	...
Japan	29·8	...
Roumania	...	37·0
Poland	...	32·2
Hungary	3·5	20·0

Non-economic Benefits.

Besides these economic benefits of the co-operative movement the social, moral and educative effects which can be reaped as bye-products are very many. Mr. J. M. Maitra says " instances can be multiplied to indicate the indirect effects of the movement. How it promotes the social and moral improvement of the people, brings about reformation of bad characters, creates a desire for education, encourages the settlement of village disputes by arbitration, discourages litigation, promotes a wider outlook on life and makes village life healthier in all its relations ! " An increasing sense of unity is prevailing in villages.[19] The social effects are in no way negligible. Thanks to the provision of Section 34 of the C. S. Act of 1915 which forces registered societies to contribute about 10 per

Rs. 4,000 on improving communications and also gave a donation of Rs. 5,000 to the N. Agricultural Associations. It also maintains night schools and girls' schools,

cent. of the net profits arising out of their actual working after contributing to their reserve fund to any charitable purposes, the village education, sanitation, and medical relief are being attended to out of these funds. In the United Provinces the Co-operative Societies utilised this fund for looking after the sanitation of the villages. In Bombay the Famine Reserve Fund has been inaugurated. Though the nucleus of the fund was originally provided by private depositors yet it has received substantial increment out of the funds of the co-operative societies. Speaking of the utility of the co-operative society Mr. Wolff [20] says there has indeed never been a Midas-Like touch of this beneficent power nor so fruitful a generator of popular education, stimulating with the growth of worldly possessions, the thrist for knowledge and the longing for higher treasures and knitting people together by a community of feeling into an enlarged family." [21]

Slow and steady wins the race.

While rural credit has made such rapid strides yet many of its votaries are not satisfied with this astonishing growth. Since Sir D. Hamilton pointed out the slowness of its growth other writers have been commenting on the selfsame features. Mr. G. K. Devadhar says "we have today 750,000 villages and the number of co-operative societies is a little over 62,000. Out of this 52,000 are purely agricultural societies.[22] Their membership represents a little over 17 lakhs. If we take it that one member represents one family we have to multiply the 17 lakhs by 5.[23] That shows that out of the present population so many in the agricultural areas are being served by the co-operative movement." Manu Subedar

[20] See H. W. Wolff, Rural Reconstruction.

[21] A tacit recognition of this led the French Government to grant ten million francs for the reconstruction of co-operative societies in the war ravaged territories. In Germany and Italy also many co-operative societies were started immediately after the war. This has been due to the desire to eliminate the profiteer. Financial assistance was also given in Italy to the Co-operative Societies so that agriculture and industry may rapidly recover from the ferment produced by the war.

[22] For more recent figures see para. 372 of the Royal Commission on Agriculture.

[23] See para. 373 of the Royal Commission on Agriculture which comments on the defects and thus indirectly suggests remedies.

clinches the issue in an excellent manner when he remarks: "I do not expect to see the co-operative movement embracing within its fold even half the agriculturists in this country in the next ten years. I therefore see the need for other ameliorative measures which would secure the benefit of cheaper finance to agriculturists not yet influenced by the co-operative movement." It has been pointed out that Rome was not built in a day and if it had been it would not have become "the eternal city." What is required is caution, safety and enduring success. Co-operation needs quality, moral and technical, and not mere quantity. Better management of the existing primary societies, checking the evils of unpunctuality in the payment of loans and the baneful practice of making book adjustments as taking benami loans, is far more important at the present stage than the mere growth of many unstable societies.

Sir Daniel Hamilton says: "The country is still in the grip of the Mahajan." Mr. Wolff points out, "It is the bonds of debt which shackle agriculture. It is usury, rankest, most extortionate, most merciless usury, which eats the marrow out of the bones of the ryots and condemns him to a life of penury and slavery in which not only is economic production hopeless but in which also energy and will become paralysed and man sinks down beaten into a state of resigned fatalism from which hope is shut out and in which life drags on wearily and unprofitably as if with no object in view. There is no use denying the fact. It is plain to all eyes." These remarks are amply substantiated by a study of the problem of the agricultural indebtedness of this country. The poverty problem is a wider one. Although indebtedness is one cause for economic poverty yet its extension would not remove the basic reasons for the poverty of the individual character and social life of the agriculturist.

Extension to other fields of activity.

To realise greater benefits out of the co-operative movement the current of co-operative activity must be advanced in other directions.[24]

[24] See my monograph, The Future of our Agricultural Industry, chapter on Agricultural Co-operation and its Difficulties. Published in the Welfare, Calcutta.

There should be simultaneous advance in other branches of co-operation. Agricultural improvement by purchase and sale and co-operative insurance societies, the undertaking of contract work by the co-operative labour unions, building societies, rural reconstruction societies, industrial co-operation, consumers' co-operation including the permanent labourers and lower classes of people in cities and many other forms of co-operative organisation are needed if economic relief is to be secured. Co-operation is undoubtedly the greatest instrument in the field of social reconstruction. With larger amount of capital, constructive skill, and forceful ability, a co-operative commonwealth can be created. India would have no need to experiment with the other alternatives to capitalistic organisation such as communism, state socialism, syndicalism and joint control in industry. The co-operative movement is the most effective level to move the wheels of economic progress in this country. The co-operative movement does not encroach on the individual freedom of the co-operators as Bolshevism does nor does it need the driving force of a dictator as Fascism requires in order to make it an effective instrument for solving the industrial and the economic problems of the country. It is inherently superior to Bolshevism, Fascism, Individualism and Socialism.

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CHAPTER XV

THE EXTENSION OF THE CO-OPERATIVE CREDIT MOVEMENT.

While criticising effectively the suggestion of the extension of the present-day type of the Co-operative Societies attention has been drawn to the necessity of making them realise the true and right spirit of the co-operative movement. Real self-help, mutual trust, neighbourly help and corporate responsibility which are the fundamental features of true co-operation should pervade all actions from the procuring of credit down to the smallest line of economic activity of our people. The number and variety of lines of co-operative activity in the field of associated human action should increase and the co-operative credit movement itself should be planned on scientific lines so as to maximise the benefits and minimise the human efforts needed to secure these advantages and enjoy an honourable living.

Times without number the author has pointed out the disadvantages of lack of specialisation in the field of credit. But some Provincial Banking Committees and a few theorists advocate the combined working of the short-term and long-term loans on the part of the present-day co-operative credit societies. Reference to existing conditions is usually cited as a justification for the recommendation. The example of Germany and the theoretical possibility of segregating the two lines into two distinct departments is also often quoted in support of their reasoning. Whatever might be the compelling necessity to grant long-term loans for redeeming mortgages or for making productive improvements on land, such an unwise combination of two different lines of credit in one and the same hands is bad, illogical and dangerous.[1] That two redoubtably pernicious tendencies have resulted out of this attempt to dole out the twofold lines of credit by one and the same institution has to be understood in this connection. Firstly, the tendency to demand long-term loans even for legitimate short-term purposes has crept in. The prevailing illiteracy is such that the *right*

[1] See the Calvert Committee's Report which advocates the entire separation of these two features of credit, *viz.*, short-term and long-term credit.

use of credit at the *right time* to the *right limit* is not understood by the people. Secondly, the co-operative short-term credit is purely based on personal credit and personal security. When once the mortgage of material security or assets is tolerated for securing long-term loans the personal element would be lost or sacrificed to the mortgaged security. Mortgage credit should not be easily dispensed with. The title to land, its freedom from encumbrances, its exact value and its net income must be ascertained and this is no easy task. The financial equipment needed to lend on mortgage business can scarcely be possessed by the present-day short-term co-operative banks. Under a distinct land mortgage credit based on co-operative lines such principles would not be forgotten and the moral value of the co-operative movement would not be lost.

An examination of the latest annual Reports of the Co-operative Movement in the different Provincial Administration Reports reveals the progress of the movement in the field of credit as well as non-credit activity. So far as credit activity is concerned the system of voluntary deposits and savings deposits has been working satisfactorily in Bombay. The use of Home Safes, the attracting of long-term deposits and other types of deposits are some of the salient features of the co-operative movement in Madras. The entire dependence on fixed deposits and the rejection of current deposits form the peculiar features of the co-operative movement in Bengal. Village societies of unlimited liability with a share basis and dividends have done much to stabilise the financial condition of the co-operative society. A more prompt payment of the loans is being enforced than before. The monopolising of loans by members of Panches is being controlled effectively. Delay in the making of loans is also being eliminated. An effort is being made to extend the current of co-operative activity in the direction of non-credit activities of the people and Bengal is once again in the forefront of economic activity. Much progress has been recorded in this direction in the field of milk distribution, the prevention of malaria in villages, and the settlement of middle-class families on land. Most of the primary societies do not fall under the category of hopeless. The number of *average* and the *good* or *model societies* is on the increase while those that are usually classed " bad " societies are on the decrease. There is, however, room for considerable progress in this direction. The financing banks or the district co-operative banks

known as Central Banks are tending to provide the needed capital and have often in the past interfered too much with the administrative details of the primary societies. Their anxiety to secure the safe return of their capital literally forced them to divide this authority with the Government officials, the unions and other bodies of the primary societies. In most cases it has tended to stifle the genius and true spirit of co-operation and has made the primary units mere branches of the financing banks. The banking unions, the supervising unions and the guaranteeing unions have all been initiated to remove this danger and to run the primary societies on proper lines. But what is wanted is that the office-bearers should be held directly responsible for their action. Deregistration is too drastic a remedy and would lead to the punishment of the good members. The Central Banks besides providing the capital tend to act as the balancing mechanism of the funds of the primary societies. Highly valuable as the ceaseless training ground [2] for the village societies' directors in the field of finance they are destined to play an important part in fusing an organic touch between the primary societies and the wider money market of the country. In addition to this they can initiate new lines of co-operative activity on behalf of the member societies, supervise and control their activities by their eternal vigilance, although the Government auditing and inspecting staff or the honorary workers of the supervising Federation are supposed to be doing the same. Provided with more fluid reserves the co-operative banks can easily finance the short-term financial requirements of the primaries.[3] Accepting deposits at high interest rates and investing these excessive funds has very often led to over-financing. The principle of surcharge would tend to make the Managing Committee of banks alive to their real responsibility.

[2] It can be stated that businesslike dealings exist here alone. Their paid Secretaries, the careful manner of handling cash resources, the exacting of securities from people handling the bank's cash are instances of wise and efficient management and the primaries can learn this aspect much to their advantage. But the financial responsibility is theirs and it should never be neglected.

[3] Departmental Reserves would be an advantage. Dependence on the overdrafts of the Imperial Bank for the formation and augmentation of the fluid resources is bad and ought to be removed at the earliest stage. It is not prudence to count on these unstable funds as part of their fluid resources. The present practice of counting upon the Imperial Bank for supplying 75 per cent. of their fluid resources is bad.

To complete the financial structure the apex provincial co-operative bank has been created to act for the District Banks much in the same manner as the District Central Bank does for the primary societies. A close nexus has not been established between this organised provincial co-operative finance and the short-term money market. High money rates might be prevailing in the short-term money market but the extra deposits of the financially strong provincial apex banks are not transferred to mitigate the tightness. Investing in Government Securities or depositing in commercial bank [4] or lending them to other Apex Provincial Co-operative Banks are the present-day features. Paucity of funds is remedied by depending on the Imperial Bank which grants cash credits and other joint-stock banks who are now discounting the co-operative paper rather freely.

The starting of a Central Bank of Issue with regional branches would simplify this matter. Co-operative surplus money can be made available to trade and commerce and *vice-versa*. Fluidity of capital which is now at present secured by holding excessive Government investments can be secured out of this arrangement. The main duty of the Central Bank then is to link and co-ordinate the co-operative short-term rural finance with the short-term money markets of the different financial centres. The starting of an All-India Co-operative Apex Bank would tend to defeat this laudable endeavour. It might tend to perpetuate the present aloofness of co-operative finance from the general financial machinery of the country. An alliance with the outside financial sources is absolutely indispensable for the co-operative movement at its present stage.

Now that the co-operative land mortgage banks have become an accomplished fact the retrograde measure of fusing short-term finance

[4] In Bengal there is the lending of these deposits to trade and commerce and investing in Government Securities. As the deposits increase at the time when there is monetary stringency in the market they can be placed safely as short-term deposits in commercial banks. This method of treating superfluous money is better than lending to building societies and other forms of co-operative activities needing long-term loans to finance their activities. The best remedy for surplus co-operative funds in the hands of the Apex Provincial Co-operative Banks is to stimulate agricultural activity by granting liberal loans to District Central Banks and help the process of orderly marketing on the part of the agriculturists.

with long-term finance should not be recommended by the Central Banking Committee.[5] As it is possible that tenants possessing no mortgageable right in land they cultivate, require capital for long-term purposes, the joint-stock land mortgage banks for these can also be started on the material securities they might hold and as these would generally be of limited liability character, for the same member cannot hope to be a member of two unlimited co-operative credit societies, the guarantee or surety of another member not indebted beyond his means can be taken as the basis for the loan to be granted to the principal borrower from this type of joint-stock Land Mortgage Banks.[6] The co-operative land mortgage banks intended for landlords, can indeed be of use only when these tend to cultivate the land. Even the societies of these owner-cultivators can be materially helped by the initiation of Registration of title to land as in the case of the *Torren's Title of Australia.* With a further simplification of the legal formalities involved in the transfer of immoveable property the possibility of conducting these land mortgage banks [7] without a hitch can be easily realised. In the early days when the investment habit will not be created the declaration of the land mortgage bond which would be floated by the federated Provincial Land Mortgage Bank as a trustee security and perhaps also the State guaranteeing of interest and principal would also be of signal advantage. The matter of repayment spread over a long period as 20 to 25 years and equal instalments being paid along with interest annually and ½ or 1% more for the formation of a Sinking Fund which might be reinvested within the movement would facilitate the member borrower's loans from the primary society itself which would collectively be responsible for the loan amount to the district Central Land Mortgage Bank and this would in turn be responsible to the Provincial Apex Land .Mortgage Bank, which has

5 Since these lines have been written the C. B. Committee has recommended the entire separation of the two lines of credit.

6 Mr. Manu Subedar develops this idea further and says that indigenous bankers can act as guarantors.

7 Pamphlets explaining the procedure of securing a loan and the way in which the Provincial Apex Loan Mortgage Bank would work would simplify matters.

to work in co-operation [8] with the existing short-term co-operative machinery, the agricultural and the industrial departments of the State.

With an all-round improvement in the educational environment and the social surroundings of the village the success of the movement would be facilitated and just as the short-term co-operative machinery has been initiated, protected, controlled and financed, at least in the initial stages, which still continues in a modified degree to the present day in some of the provinces, the state-aid has to facilitate this movement for without the repaying of the present oppressive long-term indebtedness and the securing of further capital for financing the needed long-term improvement on land, which can afford to yield their revenue only in driblets spread over a long period, no lasting benefit can accrue out of the short-term co-operative financing machinery alone. If the much-talked of routing of the *mahajan* or *sowcar* is to be an accomplished fact, both these societies should pool their resources, activities, organising capacities and solve the indebtedness problem of the ryot. The wiping out of the existing indebtedness by Debt Conciliation Schemes has to be pushed through at the same time.

If the non-official bodies existing for propaganda work, consolidation business and extension of the current of co-operative activity into other lines are working in co-operation with the official machinery, whose business is to cautiously relax its grip in proportion to the real activity, enthusiasm and encouragement of the non-official workers the success of the movement is certain and rural regeneration would become an accomplished fact only then. Less officialism, more competent non-officialism, more propaganda work, more activity in the non-credit sides of co-operative agricultural activities, more permanent capital attracted as deposits, wider spread of higher banking knowledge imparting financial skill and the necessity for prompt repayment, the formation of a great reserve fund, the absence of the spirit of profit-hunting and tendency to commercialise co-operation, greater real

[8] This would help the easy flow of funds from the short-term to the long-term credit institutions as the exigencies of the situation demand such transfer. Again it would enable the Land Mortgage Bank to know the uses to which the borrowed money has been put to. It would be preferable for the Land Mortgage Bank to make the disbursement itself on behalf of the borrower instead of lending the sum direct to the borrowers.

honesty and more sincere earnestness would enable these people to tackle the many-sided problems facing them in actual life. This is how the Hadaspur Co-operative credit society has been able to metamorphose village life within a short period of 20 years. The success of the Society is undoubtedly due to the realisation of the cardinal fact that adequate and prompt finance would be useless without proper and productive use of the same under direct supervision and intelligent initiation and prolonged guidance of sympathetic and trained non-officials or honorary organisers who realise and possess a high sense of civic conscience. The popularising of the credit instruments such as cheques and bills would solve the currency problem to a great extent.

To-day India is a country of small farmers, often illiterate, self-contained routine men with almost a proverbial feeling of jealousy towards one another. A policy of co-operation amongst such men is particularly difficult to achieve. But time and education alone would prove their saviours and regulate their pace and activity in the right directions so that the future citizens of India might be born, bred and brought up in co-operative democratic institutions alone.

CHAPTER XVI

THE NEED FOR BANKING REFORM.

The shortcomings of the existing banks—Lack of close-knit organisation—Poor imitation of the English Banking system—Lack of Industrial finance—No proper rural credit organisation—Lack of co-ordination between the two groups of the money market—Lack of properly planned contact between co-operative banks and the money market—No properly organised investment market—The real problems before our banking system—Short sketch of re-organisation.

The Existing Banks and their shortcomings.

The existing Indian joint-stock banks can be divided into three classes, *i.e.*, the Imperial Bank with its close relation with the Reserve Bank, the immigrant banks and the local joint-stock banks. The Imperial Bank finances the internal trade to a great extent by discounting hundis and a few commercial bills that are drawn in connection with external trade. The immigrant banks develop Indian trade with their own countries and naturally assist their own countrymen engaged in the economic development of our resources. It is only with their surplus funds that they give help to Indian-managed industries carried on, on a large scale. The bigger local joint-stock banks imitate the Imperial Bank of India and conduct commercial banking. Some of the smaller Indian joint-stock banks lend money on mortgage of Zemindary properties in preference to industrial securities. Some of the loan offices in Bengal lend to the Zemindars on the security of immovable landed property, [1] on houses, jewellery and goods. The private merchant banks conduct "mixed banking" business. There is no specialisation of discounting functions or acceptance business on their part. They have not reorganised their business and developed into modern bankers.[2] They have not

[1] The Rungpore Loan Office, Limited, which was started in 1894 now owns a big Zemindary estate.

[2] In Japan several of the old merchant bankers developed successful banks. Many of the leading modern banks in Japan such as the *Mitsui* and *Konokis* are directly descended from the old merchant bankers.

imitated the practice of private bankers of other countries who publish balance-sheets in order to inspire confidence in the minds of the depositors. They have not entered into private partnership with joint-stock banks on the well-known "Commanditen" principles which are followed in Germany.[3] But the financing of internal trade is largely in their hands and it is a matter of great doubt whether a Central Bank for India can really control the credit situation when these private bankers do not form a part of the recognised credit structure.

Lack of close-knit Organisation.

The existing banking system needs thorough reform. There is hardly a banking system worth its name. The several component banks do not remember their close affinity of relations and extend mutual help and sympathy. They do not understand the duty of a bank. A modern bank owes responsibility not only to its depositors alone but also to all other banks and to the whole community. A system of banks can be aptly compared to a crowded city consisting of wooden houses and a fire breaking out in one house soon spreads to several others and soon becomes a devastating conflagration. There is no use of each bank taking precautions for itself. Unless the general standard of precaution is high the banking system as a whole will not be a sound one. India does not possess a close-knit banking organisation as in the case of Germany, Japan, France, or the United States of America. This absence of thirst for system or wholeness or close-knit organisation is chiefly due to the tendency of the Indian banks to do business "each for itself." The Imperial Bank, the Exchange Banks and the Indian joint-stock banks and the indigenous bankers work severally and not collectively. There is lack of co-operation between the ordinary commercial banks and the Exchange Banks. The Exchange Banks have always striven hard to protect their business from competition from the Imperial Bank or other Indian joint-stock

[3] *The Darmstader and National Bank* is organised on these lines and the private bankers not only stake their personal fortunes but closely supervise the work of the bank along with the directors elected by the shareholders of the bank. Their special knowledge of banking is thus enrolled on the side of the bank and about 20 % of the profits after paying the maximum initial dividend to the shareholders is usually given to them as return for their capital and services. See Dr. J. Reisser, " The Grossbanken."

banks. It is quite recently that a Central Bank of Issue has been organised with the view of eliminating the weaknesses of the decentralised system of banking.

Poor imitation of the English Banking System.

The Indian joint-stock banks copy the tendency of the English banks which justify their existence solely on the ground of profits. They aim at becoming commercial bankers having very little connection with industrial finance. It is indeed true that short-term loans are granted to industries but they can never hope to sacrifice the principle of safety and liquidity of assets which commercial banks have always to keep in view. But commercial banks alone will not create the needed credit for our agricultural and nascent manufacturing industries. That the Indian joint-stock banks have borrowed, copied and translated the chief features of the English banks is an undisputed fact. They have copied the tendency of the English banks having huge authorised capital, a part of which is subscribed and out of which very little is paid at the beginning. Like the English banks they wish to trade largely on credit. The Government of India has followed the British Government in its laissez-faire policy in the matter of banking business. Imitation for imitation's sake has produced unworthy specimens. The superficial elements alone have been copied while the really vital and progressive features of English banking have not been engrafted on our system. Branch banking, bankers' associations,[4] financial houses, bankers' institutes and guilds have not been created on the English model. The recently created Reserve Bank does not possess the traditional glory, respect and power enjoyed by the Old Lady of the Threadneedle Street in the London money market. There is a noteworthy absence of control either by the Government or by a Bankers' Association.

[4] The British Bankers' Association in which is merged the English County Bankers Association was started in 1919 to look after special questions affecting banks. The British Overseas Bankers' Association consists of the British banks having a London office. This was started in 1912. The Institute of Bankers (London), the Scotch Institute of Bankers and the Institute of Bankers in Ireland are formed mainly to facilitate the discussion of matters of common interest to bankers. See chapter on Banking Organisation.

Again a part of the financial system alone has been imitated. The Indian banks are merely pursuing commercial banking. In England besides commercial banks there are trustworthy promoters, capable underwriters and issuing houses so that industrial companies derive invaluable aid from them. The following are some of the important private bankers, issuing and acceptance houses which have registered as " limited private companies."

Name.	Date of Registration.	Issued capital.
		£
Lazard Bros. and Co., Ltd.	1919	3,375,000
Matheson and Co.	1908	200,000
Murrieta and Co.	1915	25,566
B. Newgass and Co.	1911	500,000
M. Samuel and Co.	1920	1,200,000

Some of the merchant bankers, acceptance, discount or issuing companies which are not pure-partnerships are also unlimited private companies. Among them the most important are the following :—

Arbuthnot Latham and Co.

Robert Benson and Co.

B. W. Blydenstein and Co.

Brown Shipley and Co.

Child and Co.

Dunn Fisher and Co.

Dent, Palmer and Co.

Robert Fleming and Co.

Higginson and Co.

Charles, Hoare and Co.

Federick Huth and Co.

A. Keeper and Co.

Samuel Montague and Co.

Morgan Greenfell and Co.

Sale and Co.

Newman Luebick and Co.

J. Henry Schroeder and Co.

Sparling and Co.

Thompson T. Bonar and Co.

In addition to the above there are the following partnership firms in London, conducting discount, acceptance or issue business :—

Messrs. Drummond	King Bros.
Anthony Gibbs and Sons	R. Raphael and Sons
Goschan and Cunliffe	A. Reeffer and Sons
Isaac and Samuel	N. M. Rothschild and Sons
Knowles and Foster	Seligman Bros.
Stern Bros.	Speyer Bros.

In the absence of such specialising concerns it is but natural that the Indian industrialists would look forward to their banks for this kind of business also. India made an unwise choice in selecting the English banking system as her prototype. The economic progress of Japan is solely due to her selecting the salient features of nearly every banking system in the world and engrafting them on her own banking conditions. The specialising tendency visible in the English banking system is noticeable in Japan. It has imitated the model of the French mortgage banks. It has copied, though to a limited extent, the useful branch bank system. It has borrowed the continental system of close relationship between small banks and the central bank of the country. It has encouraged the co-operative credit societies. As in the United States of America there is stringent banking legislation binding the ordinary commercial banks.[5] It committed the mistake of imitating the U. S. A. national banking system but it soon retraced its steps and started an integrated banking system with the Imperial Bank of Japan as the crowning head of the banking edifice. The whole credit system was thoroughly organised

[5] See " Banking Reform in Japan, 1927 "—Bankers' Magazine, London, March, 1928.

by banking experts borrowed from foreign countries.[6] State help and control [7] enabled the banking system to work tolerably well.

Many of the bigger and successful banks operating in this country are managed by foreigners who come only into contact with "a few of the aristocracy." Petty traders and small handicraft industrialists do not receive much help from them. So they have to pay high rates of interest for any accommodation they may get from the private bankers or the public and sometimes thriving industries suffer from insufficiency of capital or a newly created industrial company locks up the whole of the share capital in fixed assets and even to commence its operations it is handicapped to a large extent by lack of outside help from bankers specialising in industrial finance. Besides there is a total lack of co-ordination between domestic and foreign finance.

The financial organisation of rural trade and credit is not properly designed. The existing banks do not care to change the present methods of rural credit. It is growing more evident day by day that the present insufficiency and waste involved in our export trade business should be rectified as early as possible. Our export trade is left to the mercy of funds outside the country. As in "Capital-poor" countries our export trade is financed by the importing country to a great extent. Most of the big export and import houses are in the hands of foreigners who employ their agents to collect the produce from the interior and send it to the port centres whence they are shipped at their own risk and cost. The agents sometimes necessarily finance the cultivators from the beginning and the crop is practically hypothecated to them. This system of financing our internal trade for exportation purposes by capitalist exploiters is not to our best national interests. The chief harmful result of this process is that the

[6] See my article, "The Japanese Banking System and its Lessons"—The Journal of Letters, Calcutta University, Vol. XXV.

[7] Taking the recent banking crisis in Japan in the Spring of 1927 the State had to empower the Imperial Bank of Japan to advance loans to the Bank of Taiwan up to 200,000,000 yen and a greater sum of 500,000,000 yen to help the other banks. To solve the problem of smaller banks a new bank called the Showa Bank was organised with the help of the Bigger *Tokyo* Banks and in the problem of financial adjustment the Japanese state took a prominent *part*. It has been encouraging the problem of amalgamation of the smaller banks. It has strengthened the staff of the Bank Inspectors to enforce a rigorous application of banking law. As the industrial and financial situations are both healthy the task of restoring order could be accomplished easily.

capitalist merchant houses are exploiting our agriculture in their own interests. The export of rice and wheat is increasing while their production is not on the increase at all when compared with the growth of population on the other side. Cotton and jute cultivation is increasing while food production is not progressing satisfactorily. The production of commercial non-food crops for export purposes is chiefly due to the influence of cash advances of the foreign capitalist merchant houses. Thus our economic prosperity is mainly dependent on the foreign firms. The real producers get unduly low prices and the necessity to make cash payments of land revenue, rent or interest forces them to sell when the market is practically glutted. A change is needed on the marketing side and this cannot be accomplished without adequate financial support. Even in the matter of non-export crops the capitalist-money-lending traders who combine banking business also, finance these cultivators and advances are granted before the time of sowing. These traders are the sowcars or money-lenders to the cultivators. These undertake to finance the import trade in such articles as piece goods from the port to the up-country trading or distributing centres.[8] This inequitable system of exploiting agriculture and rural cottage industries either in the interest of foreign exploiters or capitalist money-lenders should be given up. The introduction of the co-operative credit movement coupled with sale and purchase societies will go a long way in remedying this state of affairs. The question of removing this rapacious middleman requires patient tackling for a long time. Proper and organised co-operative banking must play the chief part in the financing of internal transactions. At present there is too great a strain on the capitalist merchants whose hundis are discounted by the indigenous bankers and their rates of interest and discount are high and unless these form a part and parcel of the organised banking system this strain would not be relieved. Very often there is a considerable " spread " between the rates quoted by

[8] The following table shows the rates of interest which money-lenders charge in the different provinces and what profits the financing middlemen often get by tacking on marketing side of business also to their money-lending operations.

See Appendix to Report of the Agricultural Commission, pp. 26, 47, 67, 92, 107, 122, 136, 173, 216, 218, 306, 353 and 421.

The Central Banking Enquiry Committee's Report gives following figures, p. 133 :—

the Imperial Bank and the indigenous bankers. This points out the necessity of securing complete co-ordination between the two groups. Our Reserve Bank alone can succeed in co-ordinating the banking activities of the nation and in securing such control over the credit policy of the other banks as is enjoyed by the Bank of England in the United Kingdom.

The powerful immigrant banks whose sole business is the financing of our international trade display no desire to take part in the economic re organisation of our country.[9] They have no ambitious national programme for India's economic uplift. These banks remain distinctively foreign much the same as they were at the start. It is often stated that they are very willing to help their own countrymen and finance the European business firms and " agency firms " and

Provinces.	Rates charged to cultivators by primary societies. per cent.	Rates paid to Central Banks on loans. per cent.
Ajmera-Merwara	9 to 12	6 to 9
Assam	15 $\frac{5}{8}$ to 18 $\frac{3}{4}$	11
Bengal	7½ to 15 $\frac{5}{8}$	9$\frac{3}{8}$ to 12½
Bihar and Orissa	12½ to 15 $\frac{3}{8}$	10½ to 12½
Bombay	9 $\frac{3}{8}$ to 12½	6 to 8
Central Provinces	12	9 to 10
Burma	15	10
Madras	...	7½ to 8
Delhi	...	8 to 9
N. W. F. P.	...	8
Punjab	9$\frac{3}{8}$ to 12½	8 to 9
United Provinces	15	12

9 For a detailed account of their work in financing foreign trade and industrial ventures such as cotton and jute mills, tea garden and coal mines—see the Indian Industrial Commission Report, p. 9.

are not anxious to attract the accounts of small and new firms started by the Indian people.[10] An Indian firm trading under a European designation is more fortunate in obtaining accommodation from these banks.[11] They have never cared to refute any of these criticisms.[12] These are some of the drawbacks of the existing powerful banks. On the other hand, it must also be recognised that the Indian-managed companies often fail to exhibit their financial position in a business-like manner to convince the European manager as to the safety of loans granted to them.[13]

Although the co-operative movement has already become an important wheel in the financial machinery of the country yet its importance has not been sufficiently realised by the Government or the other members of the money market. As the deposits of these banks are increasing and as they have to hold gilt-edged securities against them, the Finance Minister (as he would be styled in the days of Federation) should realise that there is an expanding market which will enable the Government to obtain more finance for productive works in the coming future. The Finance Minister should count on these immense potentialities instead of relying on the unstable deposits of the savings banks. An attempt should be made to fit in these Co-operative banks into the financial machinery of the country so that their seasoned glut of surplus funds might be unloaded on the money market. The surplus funds of the money market during the summer season might be safely lent through the Provincial Co-operative Apex banks to finance the agriculturists just at the time when they require it. The present system of water-tight compartments of rural, government and commercial finance is essentially backward and is a

[10] See the Evidence of R. L. Sutaria before the Indian Industrial Commission, Vol. IV, p. 291.

[11] See Mr. Manu Subedar's evidence before the Sir H. B. Smith Committee. See also the evidence of Mr. D. P. Khaitan before the Indian Fiscal Commission. Mr. T. C. Goswami repeats this same point and says that the Imperial Bank while extending credit does not treat Indians in the same way that it does its European customers. See the Report of External Capital Committee, Minute of Dissent, p. 24.

[12] The Indian Chamber of Commerce questioned the P. and O. Banking Corporation as regards its practice of refusing to lend on Life Insurance Policies of sound Indian-managed Life Insurance Companies. But no reply was given to the Chamber.

[13] See my evidence before the C. B. Enquiry Committee.

barbarous relic of the older times that should be swept away at the earliest opportunity. The first step in the re-organisation of the financial machinery of our country has been achieved by assimilating government finance with the commercial financing agency and what is required at present is to forge a strong, desirable and lasting link between the three systems so that equilibrium of monetary demand and supply can be achieved with comparative ease. Increasing use of notes, cheques and bills of exchange can be brought about by the co-operative banks as the landlord and the sowcar begin to deposit their savings in them.

There is no organised investment market in the country. Both short-term and long-term investment securities should be saleable in properly organised stock exchanges and cash obtained by the holder. It is undoubtedly true that fluctuations in the value of long-term investment would be within grêater limits than in the case of the short-term security. The investment market is only a part of the capital market and its indebtedness to the bank is apparent. Without an organised capital market it is not possible to think of an organised investment market within the country and investment banking cannot succeed unless our capital resources are thoroughly mobilised by the commercial banks and investment trusts. In the absence of such an investment market industrial companies find it difficult to obtain loans. Industrial investment practically comes up to locking up of money at present. Our stock exchanges do not facilitate the quotation of a new company's share unless the promoters are well-known. The stock exchange brokers have a few favourite scrips and any amount of skilful manipulation in their value is done in accordance with the bull or bear tendency of the times. Similar speculative tendencies exist in the produce markets such as jute and hessian.

Real problems before the banking system.

It is indeed high time that our banking system should be organised on a healthy basis giving scope for the proper mobilisation of our monetary resources. The healthy development of our trade, the careful promotion of our industries, the mobilising of scattered savings of the lower classes, the shattering of the dominance of the vast array

of greedy money-lenders, a wise economy of precious metals and the real increase of our national wealth—these are the real problems that a soundly organised banking system has to solve by promoting savings and providing savings and investment facilities and promoting the habits of thrift and by assisting the economic progress of the country.[14]

The present banking system should be thoroughly overhauled and reorganised on an improved basis. The non-existing materials should be created. The exceptional position, unrivalled organisation and vast knowledge of the Imperial Bank should be utilised to work as the initiator of banking facilities in this country. This is far more important than the other suggestion that it should be made to serve as a World Bank or the most important Indian Exchange Bank. The newly created Reserve Bank has to perfect *the currency and credit organisation* of the country and work in close association with British bankers and assure them that India will be able to participate in any scheme of Empire banking that may be inaugurated in the near future.[15] Agricultural and industrial credit for short period as well as long-term purposes should be created by new banks specially designed for such purposes. Just as the co-operative credit movement is borrowed from Germany, the German feature of close relationship between industry, finance and transportation is also worth imitation.[16] Indian economic development cannot be fostered unless there is a close alliance between banks and industries as in the case of Germany or Japan or modern Italy. Either new industrial banks having nothing to do with short-dated deposits should arise or the existing banks should take up industrial financing under proper safeguards. Full facilities for long-term investments should be created. Competition for deposits

[14] A leading English Banker echoes the same opinion before the Hilton-Young Commission where he says that "the development of banking in India is important from the point of view of currency, as counterpoise to hoarding, as incentive to economy in the use of currency, as stimulus to private saving and investment in interest-bearing securities instead of gold." See Vol. V, p. 261.

[15] The present method of divided control of Indian finances—partly in India and partly in Whitehall—has to be given up. The control over Indian finances should be vested solely in the hands of the Finance Member or Minister of the Government of India.

[16] The German banks do not aim solely at profit but consider the development of their industries as an important duty. One German director giving evidence before the American National Monetary Commission says that the "one difference between the small banks of England and Germany is that in England the primary purpose of the banks seems to be to

can be checked by following the salutary practice of linking the deposit rate with the bank rate of the Central Bank and keeping it 2% below it and raising or lowering it in conformity with the bank rate. The adoption of the banks' acceptance and establishment of a discount market are essential. The Government should see that there is no abuse of the word ' bank ' as in the past and by restraining legislation smooth the progress of the banks. A close *nexus* has to be established between the organised money-markets and the bazaar or the indigenous system under the leadership of the shroffs. An attempt should be made to profit from the experience of the continental countries by copying all their deserving features. The English banking model is not the best model nor is it suitable to our present needs. Dr. Alfred Marshall, the leading English economist, was quite correct when he wrote that " Englands' was the worst currency model that India could imitate." [17] Even in the matter of banking business we should realise that our salvation lies in selecting the salient features of all banking systems and adopt them to suit our own special circumstances. Bankers in other countries have accumulated a great deal of experience and by a close study and comparison of their features India would be in a position to select the most suitable ones. The way in which this has to be done is suggested in the following chapters entitled banking resources, banking management, banking organisation and banking legislation. However ramified the banking system would be it would take several years for it to serve as an agency of real potentiality to the country. Progress would necessarily be slow.

secure large earnings for their shareholders, in Germany our banks are largely responsible for the development of the Empire and have built up its industries." It is a matter of gratification to note that the foreign banking experts have recommended the same suggestion. The recent Companies' Act of 1936 permits the Indian banks to pursue these diverse functions.

[17] See Dr. A. Marshall, Answer 11766.—1899 Committee on Indian Currency.

CHAPTER XVII

Banking Resources

Banking resources and economic progress—More working capital to increase the economic equipment of the nation—The inadequacy of the present working capital—How to increase the deposits ?—Uniform policy towards deposits—Render *gratuitous services* rather than pay *current accounts* even—The hoarding habit—Its origin—Form of hoards, size and relative magnitude—Causes for the hoarding tendency—Social causes—Economic causes—Remedies —Few thoughtless remedies—Conclusion.

Banking Resources and Economic Progress.

Agricultural, industrial and commercial progress is dependent on banking resources. They march with banking and the banking habit with them. It is essential therefore to secure proper banking facilities which are ample for her threefold requirements. A slow and steady policy in the matter of increasing the banking resources will assure the future of the banking system itself.

More Working Capital.—The first striking feature of the Indian money market is that banking facilities are inadequate, inelastic, insufficient and ill-distributed to meet the constantly expanding needs and requirements of the country.[1] A proper geographical distribution of banks and their branches has to be secured under the aegis of the C. R. Bank.[2] The fluctuating bank rate of the Imperial Bank has almost become an integral part of her banking system and though it has appreciably lowered the average bank rate to five and half per cent. the relatively low and steady bank rate which all progressive countries of the world try to maintain and consider its raising as an unavoidable necessity due to acute stringency has not been realised. It is only two years since the Reserve Bank has been maintaining a low and steady bank rate of 3 per cent.

1 See next page for the table.

2 See my Lecture "Some Regrettable Omissions of the R. Bank Act and their Consequences," Masulipatam, The Hindu, 22nd November, 1934.

in which capital can be profitably utilised.[3] The agriculturists' demand for capital has to be reckoned. The funds for financing our foreign trade have to be taken into account and the total demand for capital under all these items would amount to a respectable figure. The internal trade of the country is certainly 10 to 15 times larger than the external trade.[4] For an adequate financing of these varied interests sufficient capital is needed.

Inadequacy of present working capital.

The amount of working capital that lies at the disposal of the Reserve Bank, the Imperial Bank of India, the Exchange Banks, the Indian joint-stock banks, the co-operative banks and the private bankers is totally inadequate for raising the needed credit structure to meet the situation. It is not commercial banking facilities alone that are needed but industrial and agricultural credit should be properly developed so as to produce satisfactory results. It must not however be supposed that our joint-stock banks do not aid the agriculturists or the industrialists. It is nothing but mere physiocratic reverence for agriculture which Ricardian Economics has failed to completely dispel even to this day that makes possible this line of criticism. Commercial banks do help agriculture and industry indirectly at least by making advances to the merchants to whom they can sell these products. Thus the broadening of the market is the indirect service that the commercial banks generally perform towards agriculture and industries. It would be

A number of new schemes to harness the waterfalls of the Western Ghats, the smelting of zinc and copper, the production of sulphuric acid on a commercial scale, the treatment of coke bye-products, the production of heavy chemicals and aniline dyes, the manufacture of textile machinery and mill accessories and the building of petrol and oil engines are some of the new industrial activities that are contemplated by the organisers of India's industrial development.

[4] The internal trade was computed at 1,597 crores in 1919-20 and 1,497 crores for 1920-21 and 2,000 crores for 1921-22. As Prof. Fisher says the internal trade cannot be more than the amount of produce available for exchange. In India a great number of middlemen intervene between the producer and the ultimate consumer of goods. This leads to greater frequency of transfer of goods from hand to hand. The official method of calculating is to consider the amount of our produce once as exports and once as imports and the total figure is considered as the amount of internal trade.

easy to construct a table which shows the position of banking business in the principal countries of the world. It would show that the *per capita* deposits and capital in India are quite insignificant when compared with other countries.

It is a well-known fact that many metropolitan banks of London possess more capital than all the Indian banks put together as shown in the following table:—

Name of the Bank.	Year.	Paid-up Capital.
		£
Barclay	1925	15,592,372
Lloyds	1925	14,372,956
London Joint City and Midland ...	1925	11,976,890
National Provincial and Union ...	1925	9,479,416
London, Westminster and Parr's ...	1925	9,051,718

Speaking of the banking situation in India Mr. (now Sir) S. N. Pochkhanawala—the leading Indian banker—says that the total deposits in India were only 3% of bank deposits in the United States of America and 9% of the deposits in the United Kingdom.[5] There are still five hundred towns in India with populations of 10,000 and upwards which have no modern banking facilities at all.[6] So the outstanding fact is the smallness of the paid-up capital and the small size of our banks. Sir Norcot Warren while placing the scheme of amalgamation of the Presidency Banks before the shareholders of the Bank of Bengal, openly admitted this weakness of our banking system. The proposed amalgamation, he says, means "added strength and more capital to our banking system." Some of the more progressive banks are increasing their capital in order to provide the

[5] See his speech before the U. P. Chamber of Commerce, Nov., 1926.

[6] See India in 1926-27, p. 231.

needed credit facilities in our money markets.[7] The increase of paid-up capital can be considered as an indication of the stability and financial capacities of the banks. Banking enterprise is thus provided with fresh scope for its activity. It is a matter of increasing gratification to find that the Indian depositors are confiding more trust in the existing banking institutions. At any rate the Indian public are now slowly realising that "without banking capital there can be no credit and without credit the primitiveness of barbarity would remain."

(000 omitted.)

Name of the Bank.	1916.	1920.	1922.	1924	1925.
The Ajodhia Bank (Fyzabad) ...	...	...	200	259	300
The Allahabad Bank	3,000	3,000	3,550	3,550	3,550
The Bangalore Bank	110	548	600	600	600
The Bank of Baroda	2,029	1,412	2,999	3,000	3 000
The Bank of India	5,000	10,000	10,000	10,000	10,000
The Bank of Morvi	1,066	1,000	5,501	1,500	1,500
The Bank of Mysore	1,000	1,932	2,000	2,000	2,000
The Central Bank of India ...	2,500	5,000	5,000	1 6813	1,6813
The Indian Bank (Madras) ...	1,000	1,000	1,278	1,229	1,229
The Indian Industrial Bank ...	...	326	463	..	...
The Muffasil Bank (Gorakhpur) ...	199	400	147	472	473
The Mysore Industrial Bank ...	...	...	651	716	752
Nendungadi Bank ...	304	434	637	866	1,004
The Punjab & Sind Bank ...	322	376	390	399	401
The Punjab National Bank ...	1,645	1,853	2,675	3,066	3,084

[7] The following table shows the increase of the paid-up capital of the Banks. See Statistical Tables of Banks in India, 1934 Edition for more recent figures :—

Some of the Eastern Exchange Banks have also increased their capital bu it cannot be denied that a large part of their working capital is located outside the country. The most noticeable feature of the expansion of the banking institutions is the progress of the Commercial and the Co-operative Banks. Other aspects of banking, such as industrial and long-term agricultural banking, have been neglected.

Greater working capital should be at the disposal of the banks. Mr. (now Sir) M. De P. Webb prophesied long ago that "India needs *more banks* manned by *Indian men* and furnished with *Indian capital*."[8] If India were to have banks in the proportion existing in Europe we shall require about 36,000 banks and branches. All of these should be conducting sound banking on secure business lines never sacrificing security to speed in the matter of extending their branches.

How to increase the deposits ?

To secure greater working capital our joint-stock banks would have to pursue some of the following methods to increase their deposits. It has already been stated that the deposit habit has been contracted to a certain extent and that bank deposits are on the increase. Notwithstanding the statement of the foreign Banking Experts banking possibilities do not abound to any extent in this country. There should be a greater drive on the part of the banks to increase the bank deposits. The most successful method is to see that the capital of the bank is held by well-to-do men who patronise the bank. Advertisement affords scope towards the securing of deposits. Sound management would go a long way in securing confidence and the Indian Banks should advertise the personnel of the bank officers. Periodical publication of balance-sheets will do much in this direction. Education of the depositor as to the different kinds of deposits and their respective advantages has to be undertaken. Personal solicitation by bank officers who are interested in the success of the bank must be carried out. If we take English banking into consideration the main causes that led to the growth of banking deposits were the following. They have opened branches in places where private banks did not exist. They have commenced acceptance business and have opened foreign departments. Their savings department is meant for the deposits of very small sums. The general development of industries and commerce led to increased banking deposits. Finally, there was remarkable freedom from bank

8 Italics my own.

failures due to scientific and conservative management.[9] Temporary set-backs occurred now and then during periods of crises but as soon as normal state of business was once more regained progress in deposit banking continued unchecked.

Uniform Policy towards Deposits.

Any of the above measures can be pursued with infinite advantage by the Indian joint-stock banks. The existing banks must pursue a uniform policy towards deposits. The first thing that strikes the student of Indian banking is the high deposits rate paid by the banks and many people have come to the startling conclusion that "capital is more productive in India than elsewhere." Nothing could be further away from the truth than this broad and facile generalisation. Indian banks are forced to pay high rates in order to attract deposits and even for commercial deposits practically payable at call some tempting rate has to be offered. The initially starting working capital of the banks is very low. They are forced to *rely* on deposits. They have formidable competitors in the co-operative credit societies and the Government-managed Post Office. The former pays a higher deposit rate ; the latter affords greater security. Now that the Government borrows even for short-term purposes at a high rate of interest the banks are finding it difficult to obtain permanent or fixed deposits unless higher rates are paid. No doubt the value of money has increased but the grievance is that even current accounts have to be paid for with the result that *touting* for unsafe business has been resorted to.[10]

In the London Money Market the deposit rate is always linked to the Bank rate, *i. e.*, 2% lower than it. The country banks' deposit rate seldom exceeds 4 and usually ranges between 2 and 3%. In London the commercial current account deposits are not paid any rate of interest.[11] The Bank of England does not pay even its fixed

9 See J. Sykes, "The Amalgamation Movement in English Banking," p. 114.

10 How the Punjab banks failed on account of this reason has been related in the chapter on the Indian Joint-stock Banks.

11 The balances of foreign banks are an exception to this statement.

deposits but[12] it is able to attract the deposits of other banks, of the Government and of all the richer people. It is the custodian of the nation's reserve. This deplorable feature of the absence of a dignified bank is mainly responsible for the scramble on the part of our banks for attracting banking deposits.[13]

The practice of not paying commercial current account deposits is a sound one. The American banks are trying to abolish the deposit rate for current account deposits and the Indian banks should follow suit. It might be remarked that the apparent danger would be that the depositors would not be encouraged to deposit money. The fear that commercial deposits would disappear need not be entertained for the commercial class as a whole cannot be dispensing with its banking account. The Indian joint-stock banks should render gratuitous services in the manner the London Banks are serving their commercial customers for their unpaid current accounts.[14] Of course, a united action on the part of all the joint-stock banks is required and the great advantage of this step would be that the Indian banks would not be compelled to undertake risky and unsafe business. This might seem to be a counsel of perfection but it is worth attempting.

The Hoarding Habit.

It is the duty of the banks to implant, foster, develop and universalise the banking habit. It is often stated that one of the chief causes hindering the banks in the discharge of that duty is the prevalence of the hoarding habit among the majority of the people. This hoarding which is indicated by the excessive importation of gold and silver and the non-circulation of *minted* rupees or imported gold sovereigns has really proved a nightmare. One of the arguments advanced against any scheme for adopting gold currency in circulation is the impossibility to estimate the amount of gold required for

12 During the recent war the Bank of England began to pay interest for short-term deposits made by the banks. This practice was discontinued from July, 1919.

13 Several of the banks pay brokerage fee for securing deposits.

14 See Walter Leaf, Banking, pp. 108 and 109. See also J. Sykes, "The Present Position of Joint-stock Banking in England."

purposes of coinage, if the hoarded gold and silver rupees and bullion were to be converted into the standard gold coin. It is said that much of the gold put into circulation would disappear into hoards ; and the example of 1902-04 is often quoted in this connection. There is no denying that this hoarding habit is especially adverse to the efficiency and smooth working of the gold standard system and that it would render any currency system unautomatic. Western economists say that the hoarding habit is about the most important cause of the poverty of the Indian people, and the greatest hindrance to a real and vital economic development of the country. In view of these far-reaching consequences the problem of hoarding has always been a live issue with those who talk or write of Indian Economics.

Meaning.

The late Sir Lionel Abrahams wisely remarked that " there are two words in monetary science which have a very doubtful meaning." One is ' inflation ' and the other ' hoarding.' It is indeed extremely difficult to find any definition of these terms that is at all satisfactory. The real meaning of hoarding is the unproductive locking up or burying in pits or safes of one's savings or surplus of income over expenditure in gold or silver bullion. But unfortunately it is not used exactly in accordance with this sense of the term. Even a really industrial use of specie is mistaken for hoarding. Instead of condemning the excessive consumption of the precious metals as a needless luxury it is often confused with the hoarding tendency and both the hoarder as well as the user of gold and silver are equally taken to task. On account of the lack of scientific exactitude ' hoarding ' has become the most baffling problem in Indian Economics.

The Gravamen of the Charge.

All economists may admit, in a very general sense without subscribing to the deduction usually made therefrom, that the gold that is absorbed is never disgorged, that it is ' a sink for precious metals ' and that it will take long for India to become saturated with gold. Only during times of famine or when production falls off as a result

of other causes does the demand for gold fall off ; but India would commence buying gold as soon as normal conditions are reached. But leaving aside the question of the industrial use of gold we can first examine whether India has appropriated an unduly large share of the world's gold. In this connection the statements of the Fowler Committee and the Babington Smith Committee [15] are directly to the point. The Fowler Committee says " India's holding of gold and silver is not excessive, it does not create such political difficulties as to justify a permanent refusal of the gold currency circulation in India." As regards the recrudescence of the habit since 1920 special causes have been operating towards this tendency and nothing can be generalised from this particular instance.

The more scientific significance of the charge of hoarding is simply this. If gold comes into India in payment of the favourable balance of trade, the price-level in India remains unaffected while the countries which send out that gold suffer from high money rates and depressed prices. No banking or business use is made of the imported metals. Broadly speaking the Indian people are not in active touch with the money market. A rise in the bank rate or any other stimulant such as the starving of currency fails to bring out the precious metals. The Indian hoarder is not a *homeo œconomicus* but he is unable to understand the movements of the money market and usually keeps himself aloof from it.

This fact can be proved by a reference to the statistics of the export of gold from this country. Gold comes out in days of scarcity and of high prices; then it is exported out of the country.[16] Immediately after the Great War, much gold was exported out of the country. Her ability to re-export gold is not entirely without significance. Even granting that an organised banking system exists in India it takes a very considerable time for the discount policy of the Central Bank to check this. Money is liable to come out of the hiding places and fill up the gaps. Contraction of currency by means of credit control exercised by a Central Bank cannot thus work out

15 Report on Indian Currency and Exchange, 1919, para. 63.

16 See my article "Recent Export of Gold during 1931-33."—The Mysore Economic Journal.

so smoothly in this country as in highly developed countries. Unless cash is used only as a basis of the credit structure, the adjustment of internal prices to external must be a difficult and often an insuperable task. In all questions of capital, currency and credit the economic use of money must remain in the fore-front. But in India 'hoarding' has assumed a disproportionate importance and has vitiated the discussion on the topic. It is thought that even the poor people have with them hoards of rupee coins which would be converted into standard gold coin at the currency office if the pure gold standard plan with gold currency in circulation is adopted by this country. Very great importance is attached to this liquidation of silver rupees or conversion operations which would have to be undertaken in case of the alterations of the exchange standard into a genuine gold standard system.

Origin.

As regards its origin there are people who trace this tendency of the Indian people to the days of *Nero*. There are others who regard India as the World's Silas Marner with an insatiable appetite for gold. As an interested student of Economics, I have sought, so far in vain, to get hold of the full stock of correct economic facts necessary for a conclusive judgment. But the conviction has been growing on me that the so-called fabulous hoards should be looked upon less as a " hidden danger " than as " hidden reserve " against the economic difficulties that people may be put to in the future. I may give here the methods I adopted in my enquiry. I issued a general questionnaire (see Appendix) to the shroffs in the town of Vizagapatam and interviewed the leading shroffs. Considerations of space prevent me from printing the detailed results of the interview. As this is a burning topic I reproduce my general questionnaire in the Appendix. I must say that unless such a thorough inquiry is held in all important cities, towns and places where gold and silver are bought and sold in retail by the shroffs, nothing conclusive as

[17] See Joseph Kitchin, " Oral Evidence before the Hilton-Young Commission "—Answer 13528. See his estimate in the International Gold Problem.—Oxford University publication.

regards the hoarding tendency of the people can be learned. On the antiquity of the habit, there is, however, no inconsistency of opinion. Mr. H. D. MacLeod was the first economist who started the theory of hoards and ever since that time the hoarding problem has almost become classical. He estimates the amount of Indian hoards at £300 millions. Lord Curzon says, " the whole hoarded wealth of India amounts to over Rs. 825 crores. Think of all this money lying idle or at most put out for usury or relatively unproductive forms of investment." Arnold Wright puts it at £200 millions. The Hilton-Young Commission has absolute faith not only in the hoarding propensity of the Indian people and the existence of the hoards, but also believes that silver coins for about 150 crores of rupees would come out of hoards for encashment into gold coin. That was one of the chief reasons which dissuaded them from recommending the adoption of an effective gold standard with gold currency in circulation. At one time this school of opinion, in their anxiety to retain the gold reserve in London, pointed out not long ago, that prices would rise if the gold reserve were transferred to India. Obviously there can be no rise in the price-level unless gold is allowed by its holders to circulate in some form or other in the hands of the people. The inconsistency of these two contentions has not been, I am afraid, duly appreciated.

However, it is encouraging that there are well-informed people who have specialised in the study of the production and distribution of the world's gold and who have given out their considered opinion that "there is very little real hoarding in India either of gold or silver." According to this school the hoarding tendency exists up to a certain limit and beyond this it is a myth and an exaggeration. The general impression among Indian economists [18] and publicists [19] is naturally, that India has not secured her due quota of the share of gold as yet. Even the Bengal Chamber of Commerce is of this opinion. The shortage of capital is attributed to the annual drain of money by way of Home Charges and it is contended that this drain is too big to leave any surplus capital in the country. As Prof. Marshall points

18 See Dr. Balkrishna's Memorandum before the Hilton-Young Commission.

19 See Sir Stanley Reeds' Memorandum before the Babington Smith Committee, App. J, p. 130.

out "capital can grow from the surplus of national income over national expenditure or in other words net national dividend. Any untoward call decreases the national income considerably and hence the national dividend is correspondingly reduced. There is no legitimate ground for grievance so far as the Home Charges are concerned, for they are a direct payment for services rendered to India but an appreciable amount goes away out of the country as profits of industries managed and financed by Europeans or other foreigners. Here is ground for legitimate complaint. The drain, as it is styled, impedes the rapid growth of capital in India. How is this problem to be tackled? Artificial attempts for the nationalisation of foreign capital have failed elsewhere. It is unwise to raise artificial restrictions against the free flow of foreign capital.

The Indian Fiscal Commission had to consider this problem. The Minority Report is anxious to raise some safeguards against the influence of the foreign capitalists. Such measures have failed in Germany. They have no better chance of success in our country. The only safe course is the accumulation of our capital so that our capitalists may become "the natural heirs of foreign enterprise." Quite recently, the External Capital Committee had to repeat the same idea in this connection. It is the paramount duty of every citizen who can save from his income to rid India of the domination of foreign capital and to obtain control of all the vital industries. As Lord Curzon says, "a country is in the strongest position whose capital is self-generated and self-employed." It behoves them to understand this subject in its true bearing and consider its economic significance to present-day Indian society. It is also essential for our economic progress to correct the Westerners' mistaken notion that India would be sponging up all the world's gold as soon as the Hindus begin to grow rich.

Form of Hoards.

Whatever might be their form in the past, it is an unquestionable fact that except the ignorant people who are unware of this tendency there would be few who hoard their savings in silver rupees which are so much over-valued. Silver hoards are also being replaced by gold hoards as evidenced during the years 1924-25. Even now people prefer to buy gold bullion in small quantities of two or three

tolas. The very fact that gold coin and bullion are imported and absorbed instead of the Government rupee as in the past shows that people have now realised the futility of locking up their savings in a depreciating metal. It is, indeed, true that about 150 crores of rupees are out in circulation but it can be safely supposed that they are meant to do the work of exchanging goods only and that hoards in shape of silver coin can scarcely exist in the hands of educated and enlightened people. Silver ornaments are, of course, used by them and both gold and silver are used for ornamentation to a large extent by the Indian people, mostly womenfolk and children. Gold sovereigns to the extent of nearly 100 millions are supposed to have been absorbed by the people and unquestionably the major portion of them must have been melted for ornaments.

Most people now appreciate that gold is a more desirable form than silver for locking up their savings. The poor man lays hands on silver only because he cannot obtain gold with his little savings. The generality of the people regard their ornaments as suitable for being pawned to the sowcar to meet the economic pressure on account of illness or old age. Strictly speaking the accumulation of these stores speaks highly of the prudent and thrifty habits of the people. If these slender savings are guided intelligently into the channels of banking and productive instrument a double purpose would be achieved. Without impairing its usefulness as a provision for the future such investment would also bring in its own current a return which might act as a further stimulant towards savings. Education in the right form of investment or the economic use of gold is the only panacea. They must bear in mind the advice of Adam Smith that "coinage is unproductive capital; it does nothing but pass from hand to hand and is not put to any useful purpose whatsoever." Sir D. Hamilton rightly points out that "the gold sovereign is a cheque drawn on Europe." It is unwise to hoard it or lock it up in the family vaults for the sake of safety. Hoarded wealth cannot in any way increase the economic well-being of the hoarders.

Size and relative magnitude.

As to the possible size or exact composition of the hoards it is almost impossible to say whether there is more of gold or silver or

whether more is in coin or bullion under each head. But it is usually thought that about £ 100 millions worth of sovereigns have been hoarded and that roughly 200 crores of silver rupees are in hoards with the Government and the people. Barring these conjectures nothing can be stated as regards this old, old problem. The following table shows the net imports and exports of gold of the various countries. From this it can be gathered that India is not the only country which is bent upon absorbing heavy stocks of gold annually and that no conclusion can be drawn out of the figures for 1922-25 as India was starved of gold during the war years.

In millions of dollars.

Year	U.S.A.	England.	France.	Japan.	Germany.	India.
1900	+ 13	+ 39	+ 64	...	+ 30	+ 0·3
1905	+ 3	+ 39	+125	+ 3	+ 35	...
1910	+ 1	+ 29	+ 11	− 3	+ 43	+ 28
1915	+421	−136	− 15	− 8	...	− 4
1920	+ 95	−122	− 18	+196	+ 4	+ 10
1925	−134	− 39	...	− 13	+133	+146

The absorption of gold in India during the century can be noted by a glance at the following figures [20] :—

Crores of Rupees.

Quinquennial.		Balance of Trade in favour of India.	Net imports of gold.
1899-1900 to 1903-04	...	40·24	6·18
1904-05 to 1908-09	...	45·59	9·35
1909-10 to 1913-14	...	72·56	28·15

[20] See the Report of the Controller of Currency, 1930-31, Statement IV, p 52. See also the Annual Review of Trade, 1930-31.

Quinquennial		Balance of Trade in favour of India.	Net imports of gold.
1914-15 to 1918-19	...	66·58	7·88
1919-20 to 1923-24	...	39·33	20·99
1924-25	...	146·87	73·93
1926-27	...	90·23	19·40
1928-29	...	76·75	21·20
1929-30	...	69·28	14·22
1930-31	...	43·24	12·75
1931-32	...	88-39	57·97
1932-33	...	64·95	65·52
1933-34	...	90·23	57·05

So far as silver is concerned India is undoubtedly one of the largest consumers of silver and the following table shows the silver consumption of a few prominent countries.[21]

(In millions of fine ounces.)

Year.	World's production.	India.	China.	U S A.	France.	England.
1900	174	49	...	...	...	2
1905	172	84	...	...	...	13
1910	222	65	26	...	...	27
1915	173	33	22	24	20	29
1920	173	4	113	29	...	4
1925	240	142	...	...	...	...

[21] See *ibid*, p. 281, Vol. V (Net Export).

Prior to 1900 there was the absorption of silver and the late Joseph Kitchin says that in the sixty years from 1834 to 1894, India absorbed silver to the extent of £320 millions and for the 30 years since that date it can be calculated that she has taken £ 303 millions of silver.[22] The aggregate absorption in the 90 years is 4,566 millions of fine ounces or 34% of the world's production [23] and of this nearly two-thirds may have been converted into ornaments and jewellery or kept as a store of wealth. Imports of gold and silver into India during the decade 1921-1931 total 466 crores ; Rs. 280 crores worth of gold and Rs. 186 crores worth of silver, have been imported.

While these facts and figures are reliable they yield no definite conclusions as regards the relative size of the individual hoards. Broadly speaking, there are very few large hoards. Sir Basil Blackett, the ex-Finance Member of the Government of India, also believes this fact ; for in his memorandum to place India on the gold standard with gold currency he explicitly says that " comparatively few hoards would be large enough to buy the minimum quantity sold by the currency authorities." He does not, however, consider the action of bullionists who might combine to draw out gold by presenting the needed quantity of silver. The bullion merchants might act as representatives of the hoarders and thus defeat the gold standard scheme.

The size of the individual hoard depends on the excess of income over the expenditure and such surplus must result in some form of storing up or other, whatever might be the currency system of the country. It is necessary to consider the family budget figures in this connection. They all prove that the average Indian is very poor and his savings would not help him to hoard gold. Some gold trinkets he might possess. Of the agriculturists who form 72 % of the total population the majority cultivate small and uneconomic holdings and perhaps are groaning under the weight of heavy indebtedness. Several receive grain advances and make payments in grain and they seldom handle any appreciable stocks of money. It is no exaggeration to say that they have merely a living wage. Some

[22] See Appendix 82, The Hilton-Young Commission Report.

[23] See G. F. Shirras," The Science of Public Finance, " p. 467.

of the wealthier agriculturists like those of the Chenab Canal Colony who have large economic holdings measuring 25 to 30 acres and who sell their wheat to European agents direct are in a position to save and they undoubtedly consider " the wife's person as their bank."

Large numbers of the artisan class live by their petty handicrafts. Neither they nor the bigger native manufacturers are in such a flourishing state as to accumulate hoards. The clerical class and the government servants find it impossible to maintain their existing standard of life. Except when aided by ancestral property which is becoming more scarce they find it impossible with their inadequate pay to escape indebtedness. The bulk of the teachers are low-paid and are in the same straits as the Government servants. From the recent inquiry conducted by the Bombay Labour office the people of the middle class of Bombay have an income ranging from Rs. 25 to Rs. 225 per month. The Whitley (Labour) Commission points out that the average monthly wages in Assam was Rs. 13·8 for men, Rs. 11-1-7 for women and Rs. 17-8-6 for children and wages are still lower in other provinces. Both the Bombay and Bengal Banking Enquiry Committees point out that Rs. 100 and Rs. 79 are the *per capita* urban people's and agriculturists' income. But they have to spend a large portion (60%) of their income on food and housing alone. Clothing and other conventional requirements must be taken into account before the available surplus can be estimated. It is only a few successful lawyers, medical practitioners and other professional men who can save. Since the days of the Swadeshi movement they have to a certain extent come forward with their savings for investment in industrial ventures. It is these people who also invest in the Government Rupee loans. It is not possible therefore,that in addition to the investments and the ornaments they may possess they have much to lay by in idle hoards. Their education, training and contact with banking institutions would make them depositors rather than hoarders of their savings. Figures of the Income-tax Assessors speak of the growth of savings on the part of businessmen, high salaried Government servants, successful lawyers and a few other classes. The saving number of people with incomes over a lakh of rupees has increased to a much greater extent than that of people holding incomes above Rs. 10,000.

Those earning between Rs. 2,000 and Rs. 10,000 also increase in numbers. The number of income-tax assessees is on the increase. The bullionists, the Native States, the richer professional classes, the wealthy landlords and the popular shrines and pilgrimage centres generally possess the *capacity* to hoard and have large monetary holdings at their back. But the exact proportion of their riches cannot be estimated with any precision.

It is not the richer or middle classes alone who are prone to hoard. The Government itself is a great hoarder of both gold coin, bullion and silver coin which exist in the P. Currency to a far greater extent than is *normally* necessary for securing the interchange of notes and rupees.

Some of the Native States like Hyderabad and Gwalior have also been sinners in this respect. Their stocks of the precious metals are neither a store of value nor a reserve of purchasing power as in the case of the ornaments of the middle and richer classes of people or the hoards of the Chetties and indigenous money-lenders. Of late the rulers of the Native States are shaking off the habit of hoarding and are now investing their funds in industrial enterprises. Some of the famous temples and shrines also possess hoards of coins which the devotees put in or offer as their thanksgiving to God.

Causes for the Hoarding Tendency.

The hoarding habit seems to have received sanction by the experience of centuries in India. The state of the country at the time of Mahomedan conquest was least conducive towards peace and accumulation of wealth. There was no middle class and a state of war without a permanent standing army was the result of the feudalism prevailing at that time. People lived in isolated and self-contained villages with little incentive for industrial development. Neither were the tools of the carpenter or the gold or the silversmiths or the brazier's elaborate ones requiring any investment of capital on a large scale. Though Mill and the latter-day historians have done their best to show the progressive rule of the Mahomedan rulers there was not much of organised industrial production.

One or two fine arts such as architecture, sculpture and painting might have been improved. There were indeed occasional periods of grace under benign rulers who changed the iron hand of oppression into one of silken gloves. Barbaric magnificence, insatiable benevolence, and magnificent philanthropy were usually displäyed by the princes but so far as the generality of inhabitants were concerned there was no improvement of their mechanical industry and no scope for securing additional capital. The highly ingenious and intuitive people who were famous for constructing tanks, wells and agricultural implements and whose civilisation was of a high order, certainly would have progressed much if the rulers did not care much for plunder and spread of religion than for imparting graceful arts. The universal rule of despotism must certainly have inculcated the habit of hoarding, *i.e.*, burying precious metals deep in the pit.

The rise of the Maharattas, the invasion of the Persians and the decay of the Mughul Empire brought in troubled times and must have strengthened this hoarding habit. In the words of the distinguished historian Colonel Daw, "Hindusthan was torn to pieces by factions. All laws, divine and human, were trampled under feet. Instead of one tyrant as in the days of the Empire the country now groans under thousands and the voices of the oppressed multitudes reach heaven. It would therefore be promoting the cause of justice and humanity to push the petty tyrants from the heights to which their villainies have raised them and to give to the many millions of mankind a Government founded upon the principles of virtue and justice." [24]

The East India Company which soon became the *de-facto* ruler never pursued a wise currency policy. It helped and stimulated decisively the hoarding habit of the people. The Company's exclusive reliance on the Silver Rupee instead of increasing the use of sound paper money led the people to persist in these unwise habits. Though acute monetary stringency was often felt during the days of its rule, the Company did not encourage the use of fiduciary bank paper.[24a] "Gold was practically driven out

24 See p. 387.

24a See my book, "Organised Banking in the Days of John Company," chapter on Early Bank Notes Issue.

of circulation by legal enactments from 1818 and the East India Company issued Treasury Notes which in 1856 realised a total of £967,700 in order to ease the monetary stringency." [25] Throughout the early half of the nineteenth century there was great demand for money and business was often at a stand still owing to the lack of a suitable circulating medium. The Company accumulated treasure in 40 or 50 treasuries and 40 to 50 thousand sepoys were annually employed in escorting treasure from one district to another. A sound paper currency would have sufficed for the purpose and the cupidity of the soldiers would not have been excited during the time of Mutiny by the sight of local treasuries possessing large sums. Thus there was much of brigandage, invasion and misrule and the habit of secret accumulation due to the insecurity of troubled times and political disturbances is still to be eradicated.

The habit which was generated during the Middle Ages was fostered to a certain extent by the lack of a scientific currency policy in the British period. By denying gold coin to the people and circulating overvalued silver rupees it has only attached undue importance to the gold coin and bullion. Since Sir James Begbie [26] first propounded this thesis much prominence has been given to it by the critics of the Government currency policy. This is not the proper place to examine in detail the Government's monetary policy which led to the popularisation of the overvalued token currency in preference to full-value coins or representative paper money.

[25] See also J. W. Kaye. "Administration of the E. I. Company," pp. 37-38 Kaye observes that "industry was paralysed, trade was at a standstill; people buried their money in the ground. It does not a little trouble as wrote one of the Company's Chief Servants to pay 9% for what money we shall be forced to take up for your account towards providing of goods for the next year and at that rate little can be had, everyone rather burying their money than adventuring to trust it out in time of war. And with good reason too was the treasure buried deep in the ground for another of the old Company's servants writes about the same time that upon any occasion of war the King will either have the purses or also purse and head. Nothing was more dangerous in those days than to be the possessor of a little available coin. The Mogul Princes opened their loans at the edge of the scimitar."

[25a] See Dr. B. R. Ambedkar, "The Problem of the Rupee," p. 34.

[26] See his note appended to the Chamberlain Commission's Report, paras. 6 and 10.

Social Causes.

Social causes were tending towards the same goal. The use of gold and silver ornaments is enjoined by social and religious usage. The practice of giving *Stri Dhan* to women in shape of gold ornaments at the time of marriage is a recognised custom. An ostentatious display of gold by the people tends to confer social prestige. It is not merely the aesthetic taste of the women that can account for the excessive use of the gold ornaments. The law of *inheritance* of the Hindu population of the country debarring their women from receiving any share of landed estates or immoveable property generally induces either the father or the husband to bestow gold on these beneficiaries. The joint family system encourages the same tendency and the husband who is earning generally lavishes much of his savings in gold and silver ornaments for his wife so as to prevent the savings from being compounded in the property of the joint family. Ornaments are now considered as personal property. So long as the legal rights of women such as inheritance of real estate and property are restricted as at present this method of conferring property on them would not be given up. Without an alteration in the law of inheritance it would be very difficult to check this inordinate use of precious metals as ornaments.

Economic Causes

The lack of multifarious agencies for looking after savings as in the case of the advanced countries is another contributory cause. An ex-Finance Member of the Government of India admits this contention in the following language:—"The average poor man in India has no banking facilities; he is not sufficiently educated to have acquired the Savings Bank habit and until he improves sufficiently by education to appreciate the investment habit or until we can provide him with the necessary banking facilities, silver and gold are practically his only means of banking." [27]

If we take the example of the United Kingdom into consideration we find that there are, in addition to sound commercial banks, Trustee

[27] See Budget Discussion, March, 1921—the Indian Legislative Assembly.

Savings Banks, which act as efficient bodies in the garnering of the poor man's savings. The National Savings Certificate plan organised during the War had a twofold object, that of collecting savings and the far more important one of guiding them into safe and sound channels. Insurance Companies, Trust or Finance Companies and well-organised Stock Exchanges free from speculative tendencies also guide the general public in the choice of their investments, so that a monetary use is made of the spare cash and savings of the people. The problem here also is the utilisation of " the money that lies dormant in endless small hoards." As Sir D. M. Dalal, the President of the Bombay Committee on the rehabilitation of Government securities, says, "India is full of money and notwithstanding the general idea that it is not available for investment in my opinion it is a question of terms and security."

Another economic cause responsible for the recent recrudescence of the hoarding habit is the fall in the price of gold bullion and the uncertainty as to whether gold would continue to be cheap has no doubt led to increased imports of gold into the country.[28] It has already been stated that the import figures of gold during 1922 to 1925 are quite exceptional in nature and that no proper inference can be drawn out of them. With the steady growth of the popularity of fiduciary currency and the investment habit in the country the gold imports for non-monetary purposes will fall and a glance at the recent reports of the Controller of Currency convinces one of the decrease of gold imports into India.

Remedies.

It has already been remarked that the habit of hoarding of spare cash in the form of ornaments which is unreservedly condemned as hoarding must be changed into one of fruitful and productive investment. We must remember in the first place that the cause of it is not a mere blind slavery to the primeval instinct of acquisitiveness. The real objective is prudent provision against famines, pestilence and unforeseen contingencies. When such contingencies do arise these small amounts get dissipated into thin air. The real course is to

[28] See the Report of the Controller of Currency, 1924-25, pp. 6 and 7.

popularise an investment which possesses in addition to its productive nature all these qualities of the ornaments, perfect safety, and easy realisability. The terms of such investment must be clear to all and the collection of interest must also be looked after by a reliable and yet cheap agency. All these aims can be secured by extending investment banks or trust or finance companies in the country and under their persuasion, influence and guidance the tendency to invest would surely receive an impetus. A part of the favourable net balance of payments can be invested every year under their direction in foreign countries. It is essential that a sound banking system capable of assimilating the gold imports and regulating the consequence of gold exports from the country should be organised by our recently created Reserve Bank. Some of the richer agriculturists, middlemen and mofussil traders who have made profits during the war should be taught that banks afford the best store of value and relieve them of the risk and trouble of keeping large stocks of precious metals in their house. The advantages of a banking account have to be brought home to them in a vividly striking and appealing manner. Even those who are aware of the advantages of a banking account do not always come forward to keep one. The quick disappearance of mushroom banks which spring up now and then strengthens such disinclination to open a banking account. Hence it is important that the bigger banks should enlarge their activities so that these small rotten ones should not be allowed to spoil the public confidence. The main problem of the banker is to organise and gather the scattered capital in the mofussil, and individual transfers of money must be tackled by the banking institutions or branches transacting business once or twice a week in those places which cannot afford to maintain a regular branch. The services of the co-operative movement should also be enlisted in this direction. A more vigorous policy on their part in the direction of securing deposits would make them not only independent organisations but would have the effect of combating this pernicious tendency.

Education.

Education is, of course, a *sine qua non* of this reform. Else the masses cannot easily imbibe the idea that the proper place for

their savings is not the person of their womenfolk but the coffers of banks which can use them as the basis of the credit structure and promptly return the same if and whenever the depositor so desires.

The banking habit being mainly a habit is best inculcated in childhood. Mr. Vidyasagar Pandya suggests that " a small penny bank may be attached to certain schools as in England." Such encouragement of practical thrift would be desirable in every way. It is the duty of the bankers to point out that instead of absorbing precious metals with the available net export, surplus agricultural machinery, implements, iron, steel and such other things can be secured which would lessen their dependence on the external markets. If cheap agricultural machinery could by any means be brought to the door of the average cultivator and made available to him by some form of credit, its effect on the hoarding habit would be twofold. Firstly, it would stir up the placid contentment of the masses and indirectly help that rise in the standard of living which would not fail to act as a sharp spur to economic progress. The second advantage is the cultivator need no longer hold precious metals in the form of jewellery to serve as a kind of pawnable security.

Again the banker has to teach how the efficiency of pooled-up money in his hands would be increased by being lent out to others. Internal capital resources would be augmented to a great extent. This is our immediate duty. It would be too early to dream of India as a world's creditor nation. A modest beginning can however be made in this direction.

Vernacular circulars must be issued by each bank stating the principles of banking, the advantages of a banking account and the bankers' own progress from year to year. These will convince them as to the utility of the banks. In England, it is stated every man has his own solicitor and his own bank. Although our people are rapidly achieving the first part of the ideal much to their own detriment they have not copied the more paying and useful habit. Although it is true that India should have a far larger number of banks what matters so much is the number of people that keep banking accounts. MacLeod says " the beneficial effects of banking are produced not by the number of banks but by the number of people who keep banking accounts."

Auxiliary Remedies.

Though education in the proper investment of savings and the spread of the banking system are the primary remedies, several auxiliary measures would have to be devised so that by close working of these diverse remedies something might be done to check this unwise and uneconomic habit.

On-Tap Savings Certificate.

The introduction of the "On-Tap Savings Certificate would inculcate the investment habit." A generous response was seen in the case of the P. O. Cash Certificate which offered liberal terms. Potential capital lying in the mofussil can be gathered by this method but it would practically undermine the popularity of the Postal Cash Certificate. Likewise "Stridhan Certificates" can be issued to discourage the tendency of over-investment in jewellery on the part of our womenfolk.

Cheap and Useful Manufactured Articles.

It is also well to consider the effects of a rise in the standard of living. The provision of a large number of cheap and useful manufactured articles would lead to brisk buying and selling of commodities and people would make a business use of their spare cash and commodities and gold would be put to a more proper use. If it is spent on productive consumption it tends to improve the earning capacity of the people. This increase of the taxable capacity would confer a double advantage on society. Firstly, the people would be better able to bear further increase of taxation from a steady income arising out of a steadily improving standard of living. Secondly, increased savings on the part of the people would be an advantage to the State.

Agricultural Credit.

The perfection of the agricultural credit machinery forming a part of the general banking system would tend to produce the so-called

hoarding habit. One of the prime objects of such hoarding is to keep something which can be pawned with the local money-lenders.

Changes in Tastes and Fashions.

Economy in the use of the precious metals can be initiated to a certain extent by changes in tastes and fashions. Pearls and diamonds can be substituted for gold and silver and if the women of the upper class devote a considerable share of their income to the new objects this love of ornament would permeate the other sections of society. If the real purchasing power of the people expands recourse to precious metals for the mere love of ornament might be weakened. The newer objects selected would have to be portable and possess great value in small bulk. These would still be unproductive no doubt and cannot be recommended as a remedy for poverty-sticken people. These require productive investments.

Insurance Habit.

The development of the habit of insurance on the part of the people is also essential to weaken the tendency to accumulate precious metals as a store of value. There is no insurance tradition as it were in this country. There are very few insurance companies in India and life insurance per head of population in this country is very low.

Attracting and Encouraging Investments.

More facilities for purchasing such investments as sterling securities should be created in India.[29] This can never be done on any adequate scale so long as there are only a few forms of investment for the Indian investors. The Government of India should enable the people to hold Indian sterling loans floated in London and interest should be paid at the Government District Treasuries or

[29] The Reserve Bank of India can discount, or purchase bills or promissory notes mainly for the purpose of encouraging dealings in purchase or sale of sterling securities.

branches of the Imperial Bank of India. If this is not forthcoming banks like the Imperial Bank of India must sell Government securities on behalf of the general public besides their own constituents at a fixed charge and thus facilitate the investment habit. The Indian banks are holders of Government securities on a large scale and a healthy market in the Government Securities means a great protection to them. This they can secure by granting remittance facilities from one local Head Office to another on the security of Government paper. It should be possible to conduct more easily the formalities in connection with the transfer of securities.

The Indian Hoarder is mistaken but not Perverse.

Under proper guidance the Indian people would not feel shy of investment in industrial companies. This investment habit is on the increase and taking the 1915-25 period there was considerable investment in industrial companies. The Indian people have freely invested in the Rupee Loans and the P.O. Cash Certificates. The number of bank depositors has also increased largely during this period. During the same period jute mill shares have freely changed hands and 60 to 70% of the shares are now supposed to be owned by Indians. The Indian capitalists of Bombay are now coming forward to invest freely in bonds of the Brazilian Government. Some portions of the recent sterling loans are being subscribed by Indians here and the Indian capitalists in England are freely investing in sterling loans of the Government of India. The policy of the Government of India should be to place greater reliance on Rupee Loans so long as they can be floated in the money market. This by itself would go a long way in increasing the investment habit on the part of the people.

Alteration in the Law of Inheritance.

Much more has to be done besides the usual means of attracting and encouraging popular investments. The treatment of the evil calls for an alteration in the law of inheritance so as to enable the Indian

people to provide for their female dependents without recourse to the barren method of hoarding precious metals. It is significant that our women are conscious of this fact.[30] Unless something is done in this direction there would still be a considerable portion of the population which continues to keep its savings in the form of idle cash.

Few Thoughtless Remedies.

Besides the commonly suggested remedies education and provision of banking facilities, I have mentioned several useful methods which go more to the root of the matter and impel people to make a truly economic use of national savings. It is also essential to correct the mistaken conceptions of a few specialists who propose to tackle this evil by purposeless or ineffective solutions. The Government guarantee of bank deposits can also be suggested as an antidote to the hoarding habit,[31] but unfortunately it is not a step of unmixed or assured good as the resultant harm may possibly be greater than the gain. It is undoubtedly true that it would increase the deposit habit by placing the banks above the risk of panicky runs. But the corresponding disadvantage should not be forgotten or overlooked. The strong are made to pay for the weak and loose and careless banking methods would be fostered. The plan of mutual guarantee of bank deposits exists in some of the States of the U.S.A. But in the State of Oklahoma at least it failed miserably. The conservative bankers would be at a disadvantage. It would be better to try to prevent failures rather than concentrate upon payment after failure. Prevention is always better than cure.

Another doubtful remedy is the starving of currency which has been advocated mainly in order to dissipate the hoards and draw silver coins out of the hiding places but this undoubtedly would lead to high discount rates during the period of rarification of currency. There is no guarantee that the advantages will not be outweighed

[30] See Resolutions passed at the All-India Women's Conference, Mysore.

[31] That the U. S. A. Federal Government adopted this feature in the Glass-Steagall Act of 1933 is indeed true but in order to alleviate the banking crisis this extreme measure had to be advocated.

by the disadvantages. The return of money from the hoards and their sound investment in productive enterprises depends of necessity upon the adoption of a simple, intelligible and thereby thoroughly reliable monetary system. A change in the currency gauge is essential to get to close quarters with this problem. A gold currency would increase this habit in the first instance by making the smaller gold coins easily available. But in the long run it will release gold out of the hoards and check the propensity to hoard gold bullion and if gold currency is freely circulating from hand to hand even gold coin hoards will tend to disappear. The educational influence of gold currency cannot be denied. This is only a corollary of the well-known psychological truth which considers that "if once a thing becomes common people do not want to hoard it." Too much reliance cannot be placed on this argument.[32] Gold coins would not form a substantial portion of the currency transactions as even the smallest of them would be too large for the daily transactions of the people. The conditions for the maintenance of a free gold market have already been outlined and this is essential for people to be sure of securing the required gold.

Final Conclusion.

Even if all the lines of attack indicated above were adopted the predilection of the people for holding precious metals would still continue for some time as no civilised country has been altogether free from the habit. In France the recent attempt of the Bank of France to purchase gold by paper francs brought out £25 million of gold and gold coin in the very first week. But until the circulation of wealth tends to increase in this country and more of productive channels are found there is no use for these stored-up treasures. However assiduously the campaign may be conducted against this habit still it is impossible to envisage any practical date when it can be stated that the people are completely free from this unwise propensity.

[32] It might so happen that gold coin in circulation might be boarded and people might lose confidence in the gold specie standard itself although gold coins are available for circulation or hoarding. This is the experience of American currency authorities in 1933. See my article, "America's Abandonment of the Gold Standard," Indian Journal of Economics, July, 1933.

The process of changing this habit in India must perforce be a slow one, The remarkable degree to which the use of notes has developed in this country during the last few years makes one confident of ultimate success. But the increase of the deposits of banking institutions depends absolutely on the development of the banking habit and without banking resources a successful economic life would be impossible. The dominant need of India to-day is fresh credit for productive purposes, even though this means more money in circulation and more deposits in banks. We may soon have some need to exercise some restraint in the exportation of our capital resources abroad if we fail to develop enough capital resources for our internal productive purposes.

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CHAPTER XVIII.

Banking Management.

The personnel of the Bank Executive—Directors, Managers and Shareholders—Japan's training—The example of the United Kingdom—A Banker's Association—Its aims—Which example to follow ?—The rôle of the American Bankers' Association—One such Association needed—Suggestions—Improved form of balance-sheet.—Its periodical publication—Pamphlets to educate customers.—The management of the system by the Central Bank—Steady price-level or stable money-incomes—Credit control by bank rate.—No reserve-discount policy but money—Income stabilisation policy—Universal gold standard with stable value of gold.—Scarcity of gold and attempts to solve it—Perfection of the indices to be employed in the price-stabilisation discount policy or money-incomes stabilisation policy.

The Personnel of the Bank Executive.

The foundation of a joint-stock bank's success is solely due to the body of directors, the managers and the trained staff of banking officers who work under the immediate orders of their superiors. In India the banking system is generally under the control of the executive officers who are styled "managers" and in some cases "Managing Directors" if they happen to be directors also at the same time. The bank share is not a popular means of investment [1] as yet with our public. It would not be far from the truth if it were to be stated that bank shares are not usually in the hands of small middle-class investors as in the case of the United Kingdom. The following figures published in Walter Leaf's Banking are very instructive.

[1] The callable and reserve liability which is generally attached to the Indian Bank shares and their large denominations have precluded the smaller capitalists from securing these shares. In 'Overseas and Foreign Banking' the case is often otherwise. The shares are of manageable amount and the tendency is to reduce the uncalled or reserve liability.

Name of the Bank.	Paid-up Capital.	No. of Holdings.	Amount of average Holdings. Nominal.	In Market value.
	£		£	£
Barclay's	15,592,372	51,011	306	790
Lloyd's	14,322,956	55,668	258	774
Midland	11,976,980	57,250	209	750
National	9,479,416	41,603	225	684
Provincial				
Westminster	9,051,718	69,882	130	592 [2]
				192 [3]

It has already been stated that neither the shareholders nor the directors of the joint-stock banks are aware of their proper duties. The directors do not consider themselves as "trustees" of the depositors also. They have never opposed the reduction of the dividends nor have they suggested to the shareholders the foregoing of dividend whenever they considered either of these policies in the interests of the depositors.

While the Board of Directors meets occasionally and works through Select Committees for dealing with special aspects of business, the daily management of the work of the bank is solely in the hands of the manager or the managing director who is solely responsible for the successful working of the bank and for the superintendence of the bank officers. Although our present situation as regards the executive officers is not so deplorably hopeless as in the past still there is a lack of trained bank managers possessing complete knowledge of banking theory and an adequate amount of practical experience. The Indian Industrial Commission observes— " that there is a lack of trained bank employees owing to the absence in the past of facilities for commercial education and of any regular system of training Indians in banking work while the country folk are not alive as to the advantages of organised banking." The Lahore Committee says "that there is a strong need of promoting a knowledge of banking systems among the people and it emphasizes the necessity of training people in banking work. Pandit Madan Mohan Moiaviya says—"the Government of India should take definite steps to impart the best instruction to young Indians in banking through the best teachers it can appoint." According to him one of

[2] £20 shares, £5 paid. [3] £1 share fully paid.

the advantages of a State Bank should be the providing of facilities for training Indians in banking work.

Pandit Malaviya instances the marvellous development of Japan and its people in the banking business. "At the time of the Restoration in 1860 there was complete ignorance of the methods of finance or of banking or of joint-stock companies. National economy and national finance were both in a perilous condition." To remedy this condition a Commission under the Presidency of Prince Ito was sent abroad to study the working of the financial institutions of the progressive Western countries. The Commission studied the conditions prevailing in Europe and were much impressed by Walter Bagehot's effective reasoning for independent banking reserves. On its recommendations national banks modelled on the American National Banking System were organised. Finding out the defects of the system during the course of a ten years' trial the Imperial Bank of Japan was established in 1882 as the Central Bank looking after the banking system of the country. At the present time separate banking institutions deal with the different kinds of banking business. *En passant* it might also be pointed out that monetary difficulties including currency depreciation which were so acutely felt during the Shogun regime disappeared as a result of a foreign loan and the bank notes issued by the Central Bank. Thus Japan's example clearly proves that monetary reconstruction is nothing but banking reorganisation.

The prime requisite for possessing a good banking system is to have a number of persons who have had a good grounding in the theory of banking with a fair amount of banking (practical) knowledge in some of the different banking systems of the foreign countries. Baron Shibusawa says that the success of the banking system in Japan was due to such preliminary training in banking.[4] Shirras

[4] Before concluding the essay the writer cannot refrain from expressing his profound satisfaction at the fact that the small spring of barking business which has been so insignificant at the time of the Restoration has by a gradual process of accretion become a broad and navigable river as it is now and his conviction is that this is the result of having followed the example of European and American nations. The Japanese are very grateful for the valuable services of Mr. A.A. Shand, now a director of the Paris Bank, London, who came to Japan at the invitation of the Issue Department in 1872 acted as the adviser in banking to that department, wrote valuable books on banking, instructed young Japanese in that line and thus paved the way for the development of banking business in that country. See Count Okuma,—"Fifty Years of New Japan," Vol. I, p. 352.

echoes the same opinion when he says, "Just as the trained teachers are of first importance to Indian Education at the present time so are trained officers in sufficient numbers to Indian Banking." [5] At another place he says, "without trained leaders the banking army will never win a victory and we shall have to depend almost entirely on that hard-working body of men who bring to the East the banking wisdom of the West." He recommends "that our Universities and the colleges working in greater co-operation with Banks should do more than they have done in the past."

Even in the United Kingdom the heads of the great banking establishments are not satisfied with the quality of men who are being attracted to the bank offices. Although there is a banking career existing there attempts are constantly made to attract the best possible men to the banking business. As Walter Leaf says, "the banking career must be placed in a light so as to be on a par with the most lucrative professions existing now." [6]

The late Lord Faber, the President of the Country Bankers' Association said that "the banking career should be placed on a footing by which it will compare favourably with any of the learned or professional careers in the country." His suggestion was that "youths" already in banking service should be given scholarship to enable them to take a full three years' University course in commerce as part of their career.[7]

In future increasing attention has to be paid by the Indian Banks while recruiting their Indian element in the banking staff. It should be remembered that "the English Banker in India is not always all that can be desired of a banker. He is lacking as much as the Indian banker in that superior realisation of the nature and object of banking. It is an open secret in the money market that sometimes 'X,' the Manager of the Bank, "Speculates in the name of his personal assistant in the shares of the company and how 'Y,

[5] G F. Shirras, Indian Finance and Banking, p. 432.

[6] See Walter Leaf's Presidential Speech at the Annual Meeting of the Parr's Bank 1919.

[7] See his Presidential speech at the Annual Dinner of the Institute of Bankers, 1919 Therein he relates how American Banks recruit their clerical force from the Public Schools of New York. See also L.M. Minty, "English and American Banking Methods."

the Secretary of the Bank 'B,' gambles in cotton. That neither 'X' nor 'Y' is easily found out speaks indeed highly for the perfection of his education in so conducting his operations as to leave hardly any evidence that could be accepted in a Court of Law. Such sort of men cannot be the requisite models for our Indian Officers to copy." [8]

As we find that even the European bank official is not the ideal one, for, there is a lack of touch with the feeling of the people and an insufficient appreciation on their part of the "vital interests" of the [9] country we should lose no time in preparing and training men of our own country. The sooner we rectify this defect the easier will be the task of obtaining for India a financial ascendancy to which she is justly entitled by virtue of her natural resources and great financial strength. The formation of debating societies, the equipment of an up-to-date library in banking offices, the granting of scholarships to bank officers to proceed to Europe and America to learn the practice and methods of commercial and co-operative banks and the transacting of foreign exchange business and the contribution of articles by senior officers of banks in banking Journals to give the benefit of their experience to the junior officers are some of the measures which have to be undertaken by the banks to improve the knowledge of their staff. It is false economy to rely on an incompetent and insufficient staff.[10]

[8] See Tannan and Shah, "Indian Banking and Currency Problems," p. 241.

[9] The most important thing that the modern banks would have to note is that their European officers are trained only to evaluate the standard shares of joint-stock companies or Government promissory notes quoted on the Stock Exchange or other negotiable securities. As these would not be available in the interior they would be unable to render any service to banks in this direction. If internal trade is to be adequately financed it can only be forthcoming as a result of discounting promissory notes of the mofussil wholesale-dealers. As such negotiable securities are unattainable in this country the dependence on an expert European staff for mofussil banking is absolutely unwise. (Since these lines have been written there are several Indian officers trained from the lower ranks in charge of important posts in several of the branches of the Imperial Bank of India.)

[10] This is what most of the Loan Offices in Bengal do at present. Even the directors owe allegiance to several professions besides banking. The Doctor-Director, or the Engineer-Director or the Lawyer-Director can hardly do justice to so many irons in the fire. The improving of book-keeping and business methods is also essential and instead of

A Banker's Association.

The friendly intimacy and comradeship engendered by the presence of several banks in the Banker's Clearing House has borne fruit in the various Associations that have been started in all countries where banking progress has reached an advanced stage. The credit of starting the first Institute of Bankers belongs to Scotland. It was started in 1875 and to-day it has on its rolls about 4,022 members. The Institute of Bankers in England was started in 1879. It has now a membership of about 23,000 in round numbers. The Institute of Bankers in Ireland was started in 1898. It has on its rolls about 800 members roughly. These Institutes consist of the officials of the banks in the country. Strong bankers' institutes have been started in Canada, Australia, and South Africa on the model of the English institutes. The American Banking Institute has 160 chapters in all parts of the country. About 54,390 members are engaged in some department or other of banking business. These institutes have carried further the idea of the bankers' associations which aim at providing a common platform and a meeting place for the various banks to assemble and discuss their common topics. In Germany there is a central federation of banks and bankers to discuss banking topics.[11] In America there is held every year an annual convention of the American Bankers' Association. All interesting developments and new departures in banking methods are keenly discussed.

depending on one or two clerks to perform the sole business there should be proper division of labour and expeditious service rendered to the depositors and customers. Encouragement of short-term deposits, discounting of bills of exchange, cheques and promissory notes backed by 2 businessmen and provision for cheap remittance to other places would have to be provided and these cannot be done by the single clerk—the maid of all service as he can be termed. A new orientation which is so essential for the smaller banks to adapt themselves with the changing times, cannot be brought about in the absence of managers, directors and officers who know banking and wholeheartedly devote themselves to it eschewing all other avocations.

11 Some of the resolutions placed at the recent banking Congress held at Berlin urge the reduction of the administrative costs of the banks. Another considers the number of banks in Germany as too great. Another requires the restoration of legislation concerning banking secrecy. Another points out that bank credit should be granted on first class security only for economically productive purposes. Besides these resolutions several interesting papers concerning the economic situation of Germany have been read at the Congress.

Other Aims.

The suitability of rates charged by the various banks and their co-operative adjustment so as to eliminate competition and rivalry is one of the chief objects of these associations. Measures for banking reform and legislative proposals affecting the banks as well as their suitability or non-suitability to domestic conditions are fully discussed. A knowledge of the science and art of banking is imparted to the banking officers by means of lectures, classes, libraries, debating society and reading rooms provided by these associations. Well-conducted magazines discussing foreign banking methods and improved innovations are the usual official organs of these bodies.

Which Example to follow?

Now that an Institute of Bankers has been started in this country it is essential for it to copy the progressive American model, *viz.*, that of the Canadian Bankers' Association or the American Bankers' Association of the U. S. A. These go a step further and perform the following functions in addition to the work of propagating sound banking methods and instilling the ideas of common fraternity in the minds of the bank officials. The Canadian Bankers' Association looks after the note circulation of the various banks. It holds periodical examinations by means of its inspectors of the bank's position as regards its note circulation and reserve. It undertakes the work of liquidating all failed banks. The Canadian banking law compels every recognised bank to become a member of the Association. Its headquarters are in Montreal in the Bank of Montreal building and its executive officer is the Secretary-Treasurer. The expenses incurred by the Association on account of a suspended bank are of course a charge against the assets of the bank. The Clearing Houses in the Dominion are subject to regulation by this Association. It undertakes educational work by providing for lectures, competitive paper examinations, etc. The Journal of the Canadian Bankers' Association is a monthly publication serving as a great educative factor among the bank employees.[12]

12 See J. F. Johnson, "The Canadian Banking System."

The American Bankers' Association takes a keen interest in agricultural education. It advances money for buying a cow. The loan is to be paid out of profits arising out of the sale of its yield. It is stated that one boy obtained a profit of $100 out of this method of advance. It awards prizes and gathers all adult farmers at its luncheons affording them an opportunity to discuss their own affairs. Canada is following suit and adults as well as children are taking great enthusiasm in agricultural practice. The Agricultural Commission of the American Bankers' Association is advocating a "national drive" in the providing of new roads and pushing sanitary improvements by proposing to vote $200,000,000 for this purpose. All this is to make country life prosperous, and with the peasants' prosperity in the ascending scale the bankers would be obtaining greater deposits and more working capital for their business. The protective department of the American Bankers' Association has successfully prevented the criminal depredations against banks.

Some Notable Results.

It is true that even in the United Kingdom the idea of fraternal relationship which has been developed by the Bankers' Associations has permeated the mind of bank officials in England who have formed themselves into the Bank Officers' Guild.[13] It consists of all bank officers. Its object is to protect the interests of its members and to improve the knowledge of the junior members. To establish closer contact between the superior officers and the younger members of the staff is another useful object of these guilds. Banking has been recognised as a distinct profession with its own policies and traditions. The wider interests and responsibilities of the bank are clearly grasped so that the old narrow profit-grabbing motive is slowly yielding to the higher ideals of national development and material progress of the

13 See Dr. L. M. Minty, "English Banking Methods." Each large bank has one 'internal guild' and negotiation between the staffs and Boards of big banks are carried through the mediation of internal guilds. There is a Joint Council of these guilds which secures similar conditions of service in the different banks. The Bank Officers' 'guild' which partakes more of the nature of a common trade union is practically a moribund institution and it is not a thoroughly representative body as yet.

community as a whole. Banks are well-conducted and a spirit of noble emulation actuates all the leading concerns. National credit is guarded carefully and as a result of the better understanding of the true principles of credit, currency and capital serious panics have become an occurrence of the past. Crises still occur but the rude shocks of sudden panic are prevented by the excellent management of the banks. This is solely due to the class consciousness created by the Bankers' Association and the better understanding of the principles of banking profession which is only an indirect result of the educational propaganda of these bankers' institutes and associations.

One Such Association Needed.

If such are the manifold advantages that can be realised from the successful functioning of a really progressive Bankers' Association no time should be lost in starting such a progressive institution in this country. The Eastern Exchange Banks have an association of their own wherein are represented some Indian joint-stock banks conducting foreign exchange business. The indigenous bankers have their own associations but there is no common platform or meeting ground for all bankers, the old and the new, the immigrant and the swadeshi, the expert and the amateur, to come into contact with one another. As the Lahore Advisory Committee to the Indian Industrial Commission says, "there is no association to look after the general policy of banking development as a whole."

Suggestion.

It is highly imperative that the newly-created Bankers' Institute and the All-India Bankers' Association should bear the following points in mind. They should not only endeavour to be thoroughly representative of all banking interests but meet frequently so that they may afford scope for the free interchange of knowledge on matters that concern them all and such procedure will not fail to benefit all the banks individually and the Indian banking system as a whole.

Besides undertaking the dissemination of sound ideas the suggestion of useful reforms in banking practice and law and the spread of profitable knowledge it must be its sole object to serve as an educa-

tional force at work among the bank offices. It has to undertake a course of lectures corresponding to the "Gilbart Lectures" of the Bankers' Institute of London to tackle problems of Indian banking and arrange for the delivery of useful lectures to enable bank clerks to grasp the theory, practice and law of banking. Its monthly magazine entitled the Indian Bankers' Magazine must devote itself to all recent improvements of foreign banking methods and discuss the feasibility of applying them to Indian conditions. This is the best practicable measure that can be undertaken at present to improve the wisdom and knowledge of our bank officials. Incidentally it can do much in the collecting of useful banking statistics that might be of help to any future economist and historian. The periodical publication of balance-sheets can also be arranged for. The successful functioning of this Institute of Indian Bankers would undoubtedly lead to a unity of policy, the prevalence of common sentiment among the several banks, the enunciation of sound and high standards of banking and would soon create a spirit of *entente cordiale* between the *Indian-managed* and the *European-managed banks*. It must co-operate with other educational institutions in the country with the object of creating wider knowledge of modern business methods, thus initiating the march for secured orderly national progress.

An Improved Form of Balance-sheet common to all Banks.

We have now reached a stage at which it is easy to realise that banking success depends greatly on expert executive management. But the question of further progress greatly depends on the amount of confidence it can inspire in the minds of the public. Many of the Indian banking institutions have not as yet realised the tremendous advantages that would accrue to them by the "light" of publicity being thrown on their affairs. If only they exhibit facts and figures concerning their rapid growth something can be done to attract the deposits of the people.[14] The present balance-sheets of our

[14] The facts should not be considered in the light of institutional secrets. A systematic publication of these by the advertising department of the banks would enable the people to trust the banker and instead of locking up their funds in unproductive enterprise the people would willingly deposit their money in the banks.

banks are scarcely intelligible to the ordinary reader. They have not adopted a telling balance-sheet the figures of which are replete with information [15] Unless this is done the outsider will not be attracted to the bank much less will he care to deposit his savings therein.

A periodical publication of balance-sheets of the type recommended in the chapter on banking legislation will contribute much towards the enlightenment of the people as regards the condition of the bank and the valuable searchlight of public criticism can probe deep into the parts and produce much beneficial effects and bring about a substantial improvement in the bank's position. It is a matter of gratification to record that the English joint-stock banks have realised the necessity of publishing a monthly balance-sheet according to a set-type and the Lloyds bank, one of the Big Five, has been publishing a more informative balance-sheet than the standard advocated in the Cunliffe Committee's Report.

Again a comparison of these uniform statements of different banks published simultaneously would afford a reliable basis of criticism. These publications serve as an excellent means of self-education for the banks. The mutual criticism of the banks might result in a uniform policy of business management. So it is highly desirable that all the banks should send in their monthly statements to the Bankers' Journal which has been recently started. They can even be published in the local gazettes No reform is more desirable than a uniform balance-sheet drawn up on identical lines for all banks and this should conform to the type recommended elsewhere in another chapter or it should be arrived at by a common agreement amongst the banks themselves.

Pamphlets to educate the Customers.

The general policy of the banks must be directed not only towards giving full information to the customers as to the state of the volume and nature of the commercial credit granted by it but it should be its

[15] The balance-sheet of the Central Bank of India published on 31st December, 1923, is up to the mark in this subject and the graph illustrating the yearly progress is to be commended. All other joint-stock banks should follow its lead in this matter. Since these lines were written the Dawsons' Bank, Ltd., had been publishing "a balance-sheet that any man can easily understand." It is a pity that other banks do not emulate their noble example.

aim to issue brief surveys of finance [16] and industry to all its customers just as the Lloyds' Bank or the Barclay's Bank and other big joint-stock banks of New York do. Our banks should issue private circulars in vernacular to its business customers and banks informing them briefly as to the actual condition that prevails at the leading industrial and produce markets and have short and pertinent articles on current topics of finance. This is one of most potent means to help the branch managers to keep abreast of the times.

When the bank circulars reach the rural masses it is quite possible that they would realise the utility of banking institutions and cultivate business relations with them.

The progressive policy of the American banks is worth imitation. The pamphlets of some of the American banks educate the customers as regards the best methods of accounting so as to reduce business death-rate. Some of the American banks have produced a crop of bankers and bankmen who were prepared to speak to the clubs and associations and impart sound economic and banking knowledge. These are doing much to make the farmers consider farming as a business proposition and some of the American banks undertake to keep the farmer's books. This is one effective method of attracting customers to the bank. American banks pay much attention to propaganda and publicity. They never lose an opportunity to remind the people of their utility and bring their banks before the public by formal address at works at the dinner hour and a judicious use is made of advertisement through the Press and picture houses, by the issue of calendars and through publications. They always work on the principle that " the bank has to come to the people and not wait for the people to come to it."

It is the duty of the Indian joint-stock banks to adjust themselves to the changing economic conditions. It has been pointed out elsewhere that dependence on European banking interests and purely commercial banking as we witness in present-day conditions should be changed. With the increase of banking capital and expansion of Indian trade, Indian banks should strive to make their economic

16 The Central Bank of India has again taken the lead in this matter. It issues monthly notes of educative interest to the staff so that a more efficient and expeditious service might be rendered to the public. These notes were first issued in December, 1922.

position self-contained. They must strive to accomplish more in the future by the perfection of their executive management, use of time-saving machines which relieve them of personal expenditure, of time and effort, systematic business organisation and familiarise the people with modern credit instruments such as bills of exchange which are of very valuable service in securing liquidity of financial position in industry and trade. They must attempt to develop a highly perfected credit organisation and through credit control relative price stabilisation can be secured so that a stable and successful economic life can be ensured. Since the time when it has been disproved that " credit stabilisation is not the same thing as price stabilisation " monetary reformers have been concentrating their attention on price stabilisation and propose to achieve it by the creation of a Central Bank of Issue and delegate to it the task of controlling credit with the avowed intention and sole object of conferring relative price stability on the country. The securing of a credit policy which will stabilise the level of money incomes is the best monetary policy for a country. An inflation of credit as well as wastage of idle bank deposits have to be eliminated. A Central Bank can secure this policy quite easily.

The Utility of a Central Banking System.

Before the recent war the utility of the centralised banking system was only half-understood. The efficacy of even the reserve-discount policy was not realised by all countries. It was after mature deliberation that the United States of America discarded the decentralised banking system in favour of the centralised banking system but she managed to secure the real spirit of the system without the existence of a Central Bank itself. England, the European continental countries, Japan and the U.S.A. alone possessed this system and as a result of war-time experience not only has the centralised banking system been developed in some of the self-governing Dominions of the British Empire but also in a large number of the South American States, in the Austro-Hungarian succession States and the newly created Baltic States.[17]

[17] Memorandum on Central Banks by the League of Nations, 1924 Issue, p. 8.

It is true that in 1923 the Canadian Federal Parliament failed to enforce the idea of the centralised banking system but at last the Canadian Central Bank is going to be started (1934). Both New Zealand and the Indian Empire would have new Central Banks thus establishing *a chain of central banking* units which might enable the framing and carrying out of a broadly conceived Imperial policy in monetary and financial affairs.[18]

The economic events which led to the adoption of the Central Banking system in the Union of South Africa, the Dominion of Australia and Italy and Soviet Russia need not be recounted here. In almost all countries the Central Banks combine the issuing of credit and Treasury functions in their hands. The war-time and post-war experience shows that a proper co-ordination of the financial institutions, a really effective and unified control over financial operations, a national bank note currency which is convenient and elastic at the same time, steady monetary conditions over long periods and a rational control over the inflationary tendencies of bank credit and speculative commitments of the public on the stock exchange, can never be obtained in the absence of a Central Bank. Hence the recommendation of the Brussels International Financial Conference for the founding of a Central Bank of Issue in all countries which do not possess one such institution already [19] has ample theoretical justification for it.

But the modern currency reformers do not desire to restore the Central Bank of Issue back to the inactive but honourable rôle of a mere " bank to the other bank's or a " reserve bank " usually out of the money market but watching it with a providential eye from its olympic heights. These reformers seek to stabilise prices and in order to attain this ideal the pre-war aloofness from the money market is no longer advocated. The Central Bank of Issue in conjunction with the Treasury should aspire to regulate credit and currency in such a manner as to secure *a stable standard* of value. The old reserve-discount policy or the policy of indiscriminate creation of credit has to

18 See Monthly Review of the Midland Bank, May, 1934.

19 See the XIV Resolution of the Committee on Currency and Exchange, Brussels International Financial Conference.

be discarded for the stabilisation of exchanges, prices or money incomes or economic stabilisation policy.[20]

The New Meaning of Stabilisation.

The idea of stabilising prices became a topic of international discussion just prior to the war and Prof. Fisher's plan obtained approval of the leading economists in America and Japan.[21] But the relative stability of the value of money over the long period of the XIX Century [22] was considered as " part of the social fabric " and even economists advocated a policy of *laissez faire* in the field of money. As fluctuations in the value of money were limited to a small [23] range no great enthusiasm for currency reform could be evoked by Prof. Fisher's proposal.

The economic earthquake caused by rising prices during and after the War once more brought this problem to the forefront of economic discussion. This time it was not " academic amateurs " or " human bookworms " that started the discussion but men of business, politicians and financiers took keen interest in this matter. All these people realise that " they can no longer afford to leave the price-level to the category of which the distinguishing characteristics are possessed in different degrees by the weather, the birth-rate and the constitution-matters which are settled by natural causes or are the resultant of the separate action of many individuals acting independently or requiring revolution to change them." In America they have recently started the National Monetary Association to discuss measures to attain a stable price-level in the United States of America. The Pollock Foundation for economic research undertakes a study of events resulting out of monetary measures. The other countries are not lagging

20 See A. D. Gayer, Gold and Monetary Stabilisation or the Columbia University Commission Report, 1934.

21 See Fisher, " The Stabilising of the Dollar."

22 Approximately the same level of prices ruled in or about the years 1826, 1841, 1855, 1862, 1867, 1871 and 1915. Prices were also level in the years 1844, 1884 and 1914. See Keynes, " Tract on Monetary Reform " or W. T. Layton, "Introduction to the Study of Prices."

23 Even during the Napoleonic Wars and the period immediately succeeding them the extreme fluctuations of English prices within a single year was 22%. See Keynes, " Tract on Monetary Reform," p. 2

behind. Profs. Cassel and Wicksel of Sweden, Prof. Charles Gide of France, Profs. Pigou, Keynes and R. G. Hawtrey of England, Prof. V. Stuart of Norway and several other distinguished economists are keenly discussing the problem of stabilisation of prices. Before the Brussels Conference as well as the Genoa International Conference [24] this question was uppermost in the minds of the delegates and experts that took part in the discussion.

The primary advantages or " happy result " of a *comparative stabilisation* of prices is the stabilisation of the labour market and the maintenance of a steady output of industry leading to the social well-being of all classes in the community.[24a] It has often been thought that a steady price-level connotes stagnation of industry, a rising price-level denotes stimulation of trade and business expansion and a falling price-level spells ruination to the business people. Beyond a certain degree [25] a continuous fall in the price-level renders the production of commodities particularly those of a more durable kind such as constructive goods an economic impossibility. Though the price-level exerts a certain amount of influence on businessmen yet the inner springs that control the economic motivation on the part of the businessmen lies inherently in their business talents and acumen rather than in any outside factor like prices. As (now Sir) W. T. Layton says "rational productivity depends much more on the advance of science, discovery and on the training, education and propaganda and organization of labour than on the rise and fall of prices." He instances the progress in metal industries as Iron and Steel during periods of depressed prices.

[24] See the First Resolution of the Financial Conference.

[24a] It is not absolute rigid fixity of prices that is meant by a policy of price stabilisation. It aims at the realisation of a flexible system under which sudden changes in price-level are prevented by accurate, far-sighted knowledge of demand and control over production in accordance with demand. The aim is not to prevent changes in prices but to put an end to evils arising out of fluctuation. Enough flexibility should exist to allow for variations in the general prices, changes in the cost of production and shifts in demand." See p. 6. Stabilisation of commodity prices Volume of the Annals of the American Academy of Political and Social Sciences edited by C. P. White—Sepr., 1928. The same conception is also expressed by H. Withers when he says "we want prices to rise or fall as little as is reasonably possible and stability in paying power is a quality that is much to be derived from our money."

[25] See T. Veblen, "Absentee Ownership," p. 129.

There is almost a consensus of opinion that rising prices are to be preferred to the falling ones. The businessmen[26] and the bankers are emphatic in their declarations for a regime of rising prices. Rising prices mean rising rates of interest and increasing profits. Rising prices expand productivity and furnish scope towards the expansion of bank credit. Businessmen have to make fixed payments on wages and interest on borrowed capital and hence they make less real payments than before. This improves their position and inspires confidence in increased activity. The greater activity of a few successful businessmen has a psychological influence on the other industrialists and tends to produce an all-round expansion of industry. On the other side the wage-earners and creditors who get fixed income suffer.

Several of the economists have argued on the injuries resulting out of regime of rising prices and do not like the "illusory prosperity" of brief periods of feverish activity. Dr. Marshall has shown that the benefits of rising prices are doubtful. He remarks that "one wants very much stronger statistical evidence than one yet has to prove that a fall of prices diminishes perceptibly and in the long run, the total productiveness of industry." Dr. Lechfeldt[27] remarks that "depression of prices, interest and profits are consistent with prosperity for the employee would get more and the employer less" and this is not a bad thing in these days of unequal distribution of wealth which is at the bottom of all socialism, syndicalism, and other "isms" which aim at the express removal of this inequality. The improvement of industrial technique, the enforcing of rigorous attention towards details, the weeding out of the less capable managers,[28] the centralisation of economic power in the hands of the competent few and the enforcement of caution on the part of investors can result out of a depression and a period of low prices.[29] A boom in prices and consequent industrial production is not at all favourable either to the producers or the labourers or the consumers. As Prof. Mitchell puts it "prosperity is less favourable not for lack of funds but for lack of time and attention."[30] Several

[26] So long as the slowly falling prices confer large buying power even the businessmen do not suffer. "This is often ignored by those affected," says H. Withers, "Money," p. 61.

[27] See R. Lechfeldt, "Restoration of World's Currencies."

[28] See Prof. A. W. Flux, "Economic Principles," Chapter XIII.

[29] See Dr. Marshall's "Evidence before the Gold and Silver Commission," No. 9816 *et. seq.*

[30] See W. C. Mitchell, "Business Cycles," pp. 597-599.

other economists such as Dr. F. Simiand, Prof. A. Aftalion, and Prof. D. H. Robertson[31] have clearly shown that in the period of boom in prices the actual production or output of the workers falls. This has been the case in the coal industry, iron mines and the dock labour.

The pre-war economic ideal as regards the desirable level of prices can be best expressed in the pregnant language of Dr. Marshall: "Under an ideal currency system prices should fall at such a rate that fixed-salaried men should secure a fair proportion of man's increasing control over his material improvements." It is now no longer fashionable to consider rising prices as a "tonic, stimulant, or rise in temperature" speeding up activity. It is not germane to this topic to discuss the influence of changes in prices on the industrialists, the wage-earners, and the fixed-salaried class or on investors and the creditor and debtor classes. While this topic has been discussed in detail in the past sufficient attention has not been drawn to the advantages of a relatively stable price-level. There is nothing in a steady price-level which is inherently antagonistic to healthy industrial expansion. The stability of prices acts as a healthy check on the undue expansion and reckless promotion of worthless undertakings which are too often undertaken during the boom days of record prices. As long as the businessmen succeed in gathering "windfall profits"—out of unexpected rise of prices, they become the target of attack and various remedies such as "subsidies, price and rent-fixing, profiteer-hunting and excess profits duties" are resorted to for transferring a large part of these "windfall profits" to the State and through the State to the community in the long run. Steady prices mean "normal profits" other things being equal. Even the bitterest enemies of "capitalism," admit the necessity of proper payment to "capital," for without capital society cannot hope to live long ; labour must perish and production would fall to a low ebb.

Another advantage of stability of prices lies in the tendency to eliminate the piling up of huge stocks which ultimately results in a glut as consumers cannot respond quickly to this abnormal rate of production. The stabilisation of prices naturally brings about a slow

31 See his "Money," p. 123 *et seq.* Although he gives this example on the whole he is of opinion that "a gently rising price-level may produce the best attainable results not only for the producers but for the community as a whole."

but steady expansion of industry which would not only minimise the output in the long run but guarantee a steady level of employment to the wage-earners. Rising prices yield profits out of their own accord and the temptation to pocket profits is so strong that competing businessmen rival each other in expanding their business leading to better employment and overtime work for the labourers. But when the inevitable trade slump appears, half-time work and dismissal are the undesirable consequences facing the labourers.

It is not industry alone that would be benefited. The existence of the investing classes of the society, namely, the holders of mortgages, bonds, debentures, and preference shares would be at stake if prices were to abruptly alter from day to day. Stability of prices or the value of money would give distinct encouragement to the investing class to pile up large fortunes and as Prof. Keyne says, " the investment system has made possible all the material triumphs which are now taken for granted. The morals, the politics, the religion, and the literature of the age joined in a grand conspiracy for the promotion of saving. God and mammon were reconciled. Peace on earth was established. A new harmony sounded from the celestial spheres."

Without a stable level of internal prices in any country it is difficult to attain a stable level of exchange for as Prof. Cassel points out "the level of exchange corresponds to the purchasing power parity." Frequent changes in the internal price level of a country cannot but influence the rates of foreign exchanges and make it impossible to seriously forecast economic and business conditions.

Having realised the advantages that a comparatively stable level of internal prices would confer on society, the economists and monetary reformers propose to attain this by influencing the monetary factor. Many causes, monetary and non-monetary, exercise their influence on the price-level. The modern currency reformers however, aspire to control the price-level by exercising pressure on the monetary situation. Prices generally depend on the relationship between money [32] and goods. The real meaning of stability of prices is to stabilise this relationship between money and goods. If the stream and flow of goods entering

[32] Money does not mean metallic money alone but the sum-total of purchasing p wer which may consist of metallic money plus all other instruments of credit acting as substitute for metallic money.

into the market is ascertained and if the volume of money is made to correspond with this stream of goods, the level of prices tends to be stable. The most useful criteria to judge the volume of production are the employment index and the volume of unmarketed stock of finished goods.

It is a well-known fact that in our modern industrial society " the Banks create" the major portion of the purchasing instruments. The creation and cancellation of all purchasing power is done by the banks. If only this policy of creating credit or restricting credit can be controlled in the real interests of society, the main objective of the reformers would be achieved. The expansion or contraction of credit has to be so devised that the total stock of money is made co-equal with the volume of goods manufactured by the entrepreneurs of the society. The lending policy of the banks confers a boon not only on the borrowers of bank accommodation but society can be benefited to a large extent by enjoying a stabilised price-level. The lending policy of the banking system as a whole has to be regulated with this view-point and the Central Bank which is the guide, friend and philosopher to the other banks is the proper authority to exercise this control, for the independent commercial banks have neither the commanding influence, power, ability nor the sense of responsibility to perform this important duty. The Central Bank is the custodian of the gold stock of the nation, the ultimate repository of all legal-tender reserve of the banks, the sole issuer of bank currency and the ultimate sheet-anchor of credit in all emergencies and if it places before itself no other ideal than that of serving national requirements [33] it can secure this proper regulation of credit on which depends the stabilisation of prices.

[33] The supply of credit must be so regulated that no rise in prices and materially no fall in prices neither takes place. In order to keep demand for credit within the limits of available means the bank must apply interest rates fixed with that object in view but in their continual scrutinising of their demands for credit must also be able to effect the necessary restrictions. The main factor determining the interest rates throughout the entire banking system is the Central Bank's discount rate and in addition the Central Bank naturally possesses a very great influence owing to the general advice it is able to give to private banks as to their credit policy. A fixed value of the monetary unit can only be kept by properly controlling the granting of credit and principally therefore by a suitable discount rate. See Money and Exchange after 1914, p. 103. See also his book " The Nature and Necessity of Interest," pp. 162 and 163.

According to Prof. G. Cassel the stabilising of the price-level is the economic goal that a banking system should seek to reach. Prof. Keynes [34] goes a step further and says that "in countries where a centralised banking system does not exist this policy cannot be pursued with advantage. But they need not despair. They have only to secure a stable exchange value of their currency in another country's [35] currency whose internal value is quite stable." Mr. Keynes suggests that the U. S. of America and Great Britain should separately endeavour to secure internal stability of their price-levels. Other countries might then conveniently use the dollar and the pound sterling both nationally managed non-metallic currencies, as a basis for the stabilisation of these exchange rates. Thus even international stabilisation of prices can be achieved by this method. Only if one large trading country like the U. S. A. or Great Britain were to stabilise their rates of exchange with this country's currency not only would exchange stability be secured but prices also tend to be stable in these different countries. Though Keynes has worked out this policy in an elaborate manner the best exposition of this policy of attaining economic stability through monetary regulation and credit control is furnished by Carl Snyder, the general statistician of the Federal Reserve Board of New York. According to him there are three definite stages in that policy. Firstly [36] the stabilisation of the price level should be set down as the correct objective. A definite norm has to be established and three per cent. variation round this norm has to be tolerated. Secondly

34 Prof. Foxwell says, "its chief duty is to the business world rather than to its shareholders and its chief purpose is to maintain financial stability rather than to make profit."

35 Suppose a country "X" follows the policy and regulates the exchange rate with England by raising 40 million reserve consisting of bills and other exchange investments which can be realised on the British and "X" country money markets. A continuous purchase and sale of sterling bills will restrict the fluctuation in the exchange value of the domestic unit of the country. So long as the English price-level tends to remain stable at a certain form the country's prices tend to remain stable. If the country's price-level were to rise relatively to the British there would be a tendency for the country's currency unit to depreciate in terms of sterling. The sale of sterling bills can stem the tide for a time but the fund might become exhausted. Hence with the depletion of the fund measures for restraining credit have to be taken by the country's currency authority and this would tend to remove the causes for the continuous depreciation. Thus if exchange stabilisation with one country, say, Great Britain or the U. S. A., is established it naturally follows that the country's price-level would follow the course of the price-level of Great Britain or the U. S. A.

36 See the American Economic Review, June, 1923, p. 281; also the Journal of the American Banker's Association, Feby., 1924.

the principal means that should be adopted to secure this objective are the manipulation of the rediscount rate of the F. R. Board as done in 1923 and the purchase and sale of securities known as the open market operations of the F. R. Banks. Thirdly, satisfactory information as regards the prices has to be gathered and forecasting indices have to be constructed to permit "anticipatory" action to be taken in the application of the above measure. This is to enable the F. R. Board to take "preventive" action instead of "compensatory action" after prices have changed. To forecast the future trend of prices he depends chiefly on the index of the volume of trade and the index showing the rate of turnover of average bank deposits.

None can deny that the Bank Rate can control credit and through credit, prices. Historical examples can be quoted in proof of this fact. The raising of the bank rate can control credit and by restraining credit bring above or initiate a movement towards lower prices.[37] But this policy would be defeated if the Government would still persist in borrowing from the banks owing to its failure to balance its budget. The "monetary brake" has to be judiciously applied at the psychological movement so as to prevent the boom of which the trade depression is only the inevitable result or reaction. No delay in the use of this weapon should be made for the rise in the price level might be accelerated beyond any possible restraint.[38]

The more jealous supporters of the Bank credit policy go a step further and claim that it would solve the widespread unemployment problem that is engaging the attention of the public mind at present in all countries. It is claimed that even "trade cycles" can be effectively checked by a wise and rational control of credit. Mr. Henderson who expresses this view before the recent "unemployment

[37] Taking the Japanese banking history into account we find the C. Bank raising the discount rate from Nov, 1919, and the upward tendency in prices was arrested in March, 1920. In the U. S. A. the F. R. Banks raised the rediscount rate to 7% in May, 1920. From that date the prices have commenced their downward march. In England the Bank of England raised its discount rate 2% in April, 1920, and prices commenced falling since that date. The same is the case with Norway, Denmark, Finland, Belgium, France, and Italy. But in Germany and Austria there was no such movement in the C. Bank's discount rate during 1920 and it remained practically stationary at 5%. See the Memorandum relating to Currency issued by the League of Nations.

[38] See R. G. Hawtrey, Monetary Reconstruction, pp. 123-124.

conference held at London remarks as follows: "Let credit be controlled as neither to permit the boom nor to induce the slump when the stage of full activity is reached, let the banks hold trade there and hold the price-level steady. The moment there are signs that a boom is in progress, even though it be merely a cloud no bigger than a man's hand, let the brake on credit be at once imposed before any harm is done. The moment there are signs that a depression is under way let credit be at once offered more fully and on easier terms and then this vicious circle of reactions will be reduced to a narrower and narrower radius until it may disappear altogether." [39] Prof. E. Cannan who took part in the discussion emphasised on the necessity to curb the boom tendency or 'damp it down' but he expressed doubts as regards the efficacy of the bank rate in achieving this object. As he remarks, it is true that "the bank rate is only one charge," that the businessman has to incur and he would not be deterred in expanding the business by a "mere rise in the bank rate." The psychological influence of the rise in the bank rate would tell its tale effectively. " A 10 % Bank rate is a kind of warning to the businessmen that the boom is about to break and that prices are going to fall." This would have the desirable effect of checking business expansion for the businessmen always consider the bank rate as the signal whose indications he has to implicitly follow. As Sir Charles Addis says, "a rise in the bank rate is considered by the business people as the danger signal, the red signal warning the business community of rocks ahead on the course in which they are engaged. A fall in the bank rate is the green light indicating that the coast is clear and that the ship of commerce may proceed on her way with caution."

Prof. Keynes says that healthy markets would lead to stable production and the banks by influencing credit can create confidence in the minds of the businessmen as regards the continuity of healthy markets. The bank's sole duty is to see that businessmen do not anticipate falling prices, for it is this anticipation that causes unemployment. The businessmen should be assured, that where prices have risen by more than a certain measure due action will be taken to prevent prices from rising further and this action will diminish very

39 See his opening speech on the " Unemployment Debate at the London Conference."

much the expectation of falling prices which they would otherwise entertain."[40]

It is apparent from the above remarks that changes in prices are some of the determining factors in the instability of industry and if the banks were to administer an effective check by twisting the "monetary screw" much can be done to prevent undue expansion and mitigate the intensity of the crisis that would occur. All theories concerning the origin of the Trade Cycles emphasize on the necessity of the expansion of banking credit during the boom period. The competition theory, the diminishing utility theory checking demand, the under-consumption theory, the confidence theory, the sunspot theory, the rainfall theory, the over-capitalisation theory and the monetary theory have been propounded by the different writers to explain the crucial cause of the recurring business cycles in industrial societies. Prof. A. C. Pigou admits that monetary causes might constitute their quota towards increasing the amplitude of industrial fluctuations arising out of non-monetary causes such as harvest failures or psychological assumptions on the part of the businessmen leading to errors of forecast on their part.[41] Whatever might be the cause that sets the boom or expansion tendency into operation the changes in prices and the banks obliging the businessmen with credit are emphasized by a large number of these writers. Prof. Fisher describes the trade cycle as the "dance of the dollar."[42] Prof. Keynes who postulates that our modern society aims at monetary profits, says that " anticipated changes in prices have a profound influence on the course of production."[43] Prof. Cassel has denounced all deflationary tendencies as they produce " a paralysing influence" on the course of trade and productive processes.[4] It is no use speaking about gradual deflation. Once it is made clear to every one that "prices are to be brought down to a fraction of what they are now enterprise will very generally come to a standstill, borrowers must suffer terrible losses, banks will show themselves unable to

40 See J. M. Keynes, " Tract on Monetary Reform," pp. 36-38.

41 See his recent book, " Industrial Fluctuations," Part I, pp. 207-208.

42 Prof. Fisher, Journal of the American Statistical Association, see 1923, pp. 26-30

43 See "Reconstruction of Europe" 18th May, 1922, p. 66.

44 See Prof. G. Cassels' speech before the International Chamber of Commerce, Rome, March, 1923.

resist the shock and the working classes must be exposed to unemployment to a degree which is in itself a serious evil and which involves a great danger for the maintenance of social order." F. A. Lavington argues that business confidence is the sole cause but "price movements react upon or reinforce the rise in business confidence."[45] Thus there is a powerful cumulative influence or stimulus to trade activity. But within the movement are causes tending to destroy the confidence on which it is based, for on the one hand rising prices are sapping bank reserves and on the other the artificial profitableness of business and the excessive confidence accompanying it, leads to errors in business forecasts which sooner or later must be exposed. Prof. A. C. Pigou also reckons the influence of prices and says that " the liability of general prices to vary or in other words instability of the standard of purchasing power is a cause tending to expand the range of the movements that occur in the aggregate wage-fund. Consequently the introduction of any arrangement capable of counteracting the cause would *pro tanto* lessen the fluctuating character of the demand for the labour and therewith the average volume of unemployment.[46] Prof. F. W. Taussig considers that " changes in prices have profound influences on the mind of the middleman, the wholesale jobbers and retailers who form the immediate purchasing public for the producers." [47]

If the banks can check unhealthy expansion during boom days and avert a possible monetary crisis they can also stimulate business expansion during days of depression. The banks can give "*Castor oil* " to cure the constipation of congested currency. This can be done by several methods with or without the co-operation of the Treasury. The lowering of the bank rate so as to tempt borrowers is often advocated. This method again can succeed only if it is reinforced by the psychological influences, namely, the anticipation of rising prices and certainty of realising profits. All economists realise this cardinal fact and disbelieve the specious half-truth which says that " cheap money brings good trade," but as one economist puts it "even lending money without interest would not help if the borrower anticipated a loss on

45 F. A. Lavington, " Trade Cycles," p. 51.

46 See A. C. Pigou, Unemployment, p. 122.

47 F. W. Taussig, Principles of Economics, pp. 405-407.

every conceivable use that he could make use of the money."[48] "Even speculators realise this," says Albert Strauss. According to him "no rate however low will tempt borrowing for the purpose of purchasing a commodity whose price is believed too high and broadly speaking, no rate, however high, will by reason of its being high, restrain borrowing intended for the purchase of commodities which are believed certain to rise." Prof. Cannan also utters a warning against overrating the influence of the bank rate as the only potent instrument for securing economic equilibrium in the community. In the pictorial language of Hartley Withers "prices, credit, industry and enterprise are not a pipe for bank rates' fingers to sound what stop she pleases."

But these writers who condemn the efficacy of the bank rate weapon ought to consider that there are other supplementary measures which can be undertaken to bring about the desired end. The lowering of the bank rate can be coupled with the bank's action of lowering the deposit rate of interest to such a figure as to "push money off deposits into circulation."[49] If it is as low as the yield obtainable on investment on speculative stocks or so low as to encourage spending in preference to the form of remunerative saving, business expansion can naturally result out of the co-ordinated action of a low bank rate and an unduly low deposit rate of interest.[50] Nextly the floating of non-industrial loans by Local or Central Governments attracting the idle deposit money in the " bank pool " and causing it to be spent among the people will lead to the liberation of money tied up in the bank's vaults.[51] The Government might resort to inflation of currency as the trade depression would naturally result in a shortage of goverment revenue. The unemployment doles would increase the expenditure on the other side and the unbalancing of the budget forces the government to inflate but the temporary boom "resulting out of this increased expenditure would naturally end in a trade slump producing conse-

[48] See R. G. Hawtrey, Monetary Reconstruction, p. 142.

[49] Quoted by Hartley Withers, " Bankers and Credit," p. 170.

[50] " The policy of public construction can be so arranged as to prevent the major portion of factory unemployment and much can be done by a careful planning of the construction works that would eliminate the evils of unemployment." See Public Construction and Cyclical Unemployment, by Dr. F. Dickinson, September, 1928, pp. 205-208. Annals of the American Academy of Political Science.

[51] See B. L. B. Angas, " Reparations, Trade and Foreign Exchange," pp. 283-285.

quences more severe than the first." Banking inflation as a result of loans granted to the Government might lead to the releasing of currency out of the " banking pool " but it is not productive of manufactured goods and hence no business expansion might result.

Thus there are several methods to relax the "frozen deposits," in the banking pool but all of them would become ineffective if the consumers go "on strike" as it were and the banks cannot hope to influence them and make them borrow. This truth can be expressed by saying that " the credit system is not an automatic device that can be wound up periodically by measured forces under absolute human control."

Such are the potentialities and the limitations on the policy of credit control by the central banks. Within the limitations, however, the Central Bank's action can go a long way in imparting stability to the price-level and if we consider the other services that banks render to society one can easily understand the reason why banking and credit are regarded as the *Philosopher's Stone* by Bishop Berkeley. Saint Simon and Auguste Comte who were shrewd enough to realise the importance of credit and a banking organisation for the society long ago remarked that " the bankers might wield all political power in a well-governed community."[52] But before this cherished and desirable consummation can be brought about the banker has to realise his social obligations towards the community and strive his level best to secure a steady price-level. The banker has to remember what Dr. Marshall said long ago " that it is worth while to do much in order to diminish the variations in the value of the monetary unit a little " and act up to this worthy ideal.

Prof. Fisher and other economists realise that an absolute and dead level of stable prices cannot be obtained by the Bank rate device.

[52] There seems to be a complete fulfilment of this prophecy in Great Britain during the years 1918-1920. All measures were framed with the express object of maintaining the best credit and financial information of the city. The restoration of the pound sterling, the liquidation of Britain's indebtedness to America, the deflationary policy pursued at this time, the turning down of the protectionist practices adopted during the war time, the return to orthodox finance, the attempt to make London a distributor of capital as before in spite of internal needs, and the attempt to sacrifice agriculture and consider finance and commerce as vital factors in the national economic structure have all been due to the dictates of the city interests and these are considered identical with the interests of the nation.

If Central Banks act judiciously and in unison it is possible to restrict the fluctuations within a narrow limit. As no additional legislation is required to secure this spirit of co-operation economists place great reliance on this method and they are justified in the expectation for the "non-metallic regulated standard" of Keynes has been discarded by almost all important countries which have resorted to the gold standard.[53] The universal long-period value of gold is to be stabilised and under such a managed gold standard coupled with the price-stabilisation discount policy, relative stability of world and internal prices and tolerable stabilisation of exchanges can be obtained.

The restoration of the gold standard has been the accepted feature of the recent monetary policy. All the suggested proposals to dispense with, uproot and thrust aside gold out of the monetary system have been laid aside. King Gold—the arch-exploiter of humanity—has been restored as a constitutional monarch but there is no assurance that his position would be stable. The ingenuity of man might very soon lead to the perfection of a less wasteful and more scientific and stable standard than Gold.[54] King Gold would be deposed if he refuses to obey the behests of the Central Banks and unless he permits himself to be "managed" by others the situation would become too stiff for him. The gold standard would be made to operate as a means to an end and gold would no longer be a master but a servant of the economic life of man.

General Return of Gold.

Undaunted by the bogey of gold getting rapidly cheaper or rapidly dear and conscious of the fact that neither politicians nor bankers can easily tamper with the world level of prices which the international

[53] Even Prof. Fisher assures that other countries can follow Sweden's example and by managing money secure a stable price-level for the country. A combination of credit, budgetary, commercial and wage policies is needed to secure industrial equilibrium in society. Whether this policy of "*Konjukturpolitik*" can be adopted by other countries is not discussed. See Brinley Thomas, Monetary Policy and Crises; also Kjellstrom "Managed Money," also Fisher, "Stable Money."

[54] Keynes himself recommends a variable gold standard. See his "Treatise on Money," Vol. II.

gold standard would bring in its train, several countries have restored the gold standard. France and Italy have recently returned to the gold standard.[55] The credit and good-will of the U. S. of America was extended to them so that their return to the gold standard may be vouchsafed. Under Mr. Benjamin Strong's (Governor of the F. R. Bank of New York) advice a low rediscount rate was deliberately followed for 4 months in 1926 and again in the last five months of 1927, so as to allow the flow of gold to those countries who demanded its acquisition for establishing their currencies as a gold basis and roughly $500,000,000 worth of gold was exported from the United States of America. Whatever might be the methods by which these countries attained the gold standard and financial stability the future of the gold standard must be assured. Europe's main problem during 1925-31 was to prevent a fall from orthodoxy in current matters as it experienced during 1914-1921. Each country had to gradually possess sufficient gold against its note-issues and a substantial amount in excess of this in order to feel comfortable. Right Hon'ble Montagu Norman, the Governor of the Bank of England, expressed it clearly in the following language.[56]

While the above issue was the main problem, the subsidiary one of stabilisation of the value of gold was considered to be a more difficult one. That the necessity for " simultaneous and competitive efforts of the countries to secure gold would lead to a scramble " and consequently raise its value was fully known. It was however realised that as the U.S.A. stabilised the value of gold in terms of a dollar

55 About 31 countries returned to the gold standard during the course of five years, 1923-28. During the second breakdown of the gold standard in 1931 many countries abandoned it. At present (1935) only 5 countries are on the gold standard basis. See " The New Monetary System of the U.S.A." National Industrial Board publication.

56 " The stabilisation of Europe is dependent on having over a series of years a certain supply of gold by which those various countries can gradually substitute gold for valuata : never going back, as I expect, absolutely to a gold circulation but nevertheless, over the years, each one gradually getting a higher proportion of gold against their note-issues. That, I believe, is the way in which Europe and countries beyond Europe may eventually solve the question of stability, of security, of note-issues, of prices and of co-operation one with another all moving together forward—I believe the advantage of the many as well as the advantage of each one is that this progress should be gradual and united." See Answer 13740, Vol. V, Oral Evidence before the Hilton-Young Commission.

giving stable level of prices, the stabilisation of world prices would lead to the stabilisation of the international value of gold.

Almost all countries of the world have realised that gold can no longer be a perfect measure of value, *i.e.*, contract or increase in such a way as to maintain the necessaries of life such as food, clothing, machinery, coal and rent within a minimum of fluctuations as to value and the problem of international or world finance is to mitigate by preventive measures the financial entanglements that would be forthcoming in the train of a scarcity of gold output. The present world price-level in 1930 was 150 per cent., that of the pre-war level.[57] The main problem of the future is to keep it stable at that level. The stocks of gold must be produced in such a quantity that the present price-level might be maintained in the future and cope with the creation of increasing production of commodities which have to be exchanged with each other.

It has been noticed long ago that the output of gold is subject to great variations and does not tally with the increased wealth of the world. At times it may be produced in greater quantities than the output of commodity and services production in the other direction. The industrial demand itself is subject to great variation. An increase in the wealth and prosperity of the people usually leads to increased demand for coinage as well as industrial purposes. It was the joint committee of the U. S. Department of the Interior that first pointed out that "the future of gold production is problematical. The gold output of the world seems to have passed its zenith and to be on the decline.

[57] This does not eliminate changes in prices of commodities within any particular country. The price-level of any commodity would depend on its production and the world demand existing for it. Fluctuations in internal prices would be the result of changing efficiencies, changing imports and exports so as to keep pace with demand arising from increasing population and its growing trade requirements for the demand for gold itself might be reduced to keep pace with existing and forthcoming stocks of gold supplies The present world price-level must not be interfered with either by overproduction or underproduction of supplies with reference to demand. On the other side world prices must not be forced up by over-production or dragged down by the lack of gold. The world price-level is now unfortunately linked with the small basis of a precious metal which acts as the chief regulating factor for the value of all the articles in the world's trade.

The calculation of various experts as Prof. Cassel [58] and Lechfeldt,[59] Dr. Gregory,[60] Joseph Kit chin [61] and of the Gold Delegation Committee of the League of Nations need not be alluded to in detail here. All of them predict that there would be decrease of gold production when compared with the growing consumption of the world. The gold output seems to be on the decline and the 3% annual increase of gold that is required to maintain prices at the existing level or to keep pace with the economic development would not be forthcoming. After 1933 the scarcity of gold will be gradually felt. There would be steadily falling commodity prices, reduced prosperity, lowered standard of living and stationary trade or a slower rate of economic progress.

As against this view which the majority of economists hold Profs. Fisher, J. M. Keynes, and Edwin Cannan consider that gold inflation would result and prices in gold will not fall but will go on rising as before the war period and that to an inconvenient extent. "Unless the East is allowed to absorb gold there would be no adequate solution," says Cannan.[63] Keynes would retain gold for settling international payments and to form a war chest against emergencies but would on no score allow it to play any part in his managed system.[64] Fisher however endeavours to stabilise the price of the gold bullion dollar in accordance with the "goods dollar." [65] Any huge amount of gold can be absorbed by the banking system without any rise in prices only if

58 See G. Cassel, "Theory of Social Economy," Vol. II, 53 *et seq.* "The World's annual requirements of new gold in 1940 will be close upon 150 millions sterling and he is of opinion that it will not be possible to supply even one-half of that quota."

59 See R. H. Lechfeldt, "Gold Prices and the Witwatersrand," p. 32.

60 Dr. T. E. Gregory," "First Year of the Gold Standard."

61 Evidence before the Indian Royal Commission on Currency of 1926, Appendix 82.

62 See G. Peele, "Economic Impact of America," p 181. This fact proved to be an erroneous presumption for Russia as well as Australia are increasing the output of gold. See C. O. Hardy, "The Output of Gold," 1936, for more recent information on the production of new gold.

63 See Edwin Cannan, "An Economists' Protest," also his introduction to Dr. B. R. Ambedkar's "Problem of the Rupee."

64 See J. M. Keynes, "Tract on Monetary Reform," pp. 163-176.

65 Fisher, "Stabilising the Dollar," p. 105.

it is cleverly managed.[66] This is what the U.S.A. Federal banking system has done during 1924-1936.

While these are the diametrically opposite and conflicting opinions about the future output or supply of gold with reference to demand the present-day signs do not justify any of the above predictions of either school. After all even those who have special technical knowledge of the gold mining industry may find it hard to guess what would be dug out of the bowels of the earth.[67] Economic prophecy is futile and mischievous. The same fate may be in store for any of these prophecies which befell that of the prophetic estimate of silver production by Profs. Carpenter and Cullis.[68]

Is America holding the World's Gold Bag?

Though there is no consensus of opinion in this matter still it is true that America possesses a large stock of "free gold." Since 1914 gold was diverted to the U. S. A. and the gold standard was maintained. Gold exports were allowed under licence from September, 1917, to June, 1919. At present about £200 millions of gold certificates are in circulation and the F. R. Board has about £550 millions, *i.e.*, 70% cash reserve. A stock of say £280 millions can be released without any credit contraction. But if it were to be absorbed by the American people themselves there would not be even this 'free gold.' As bank deposits expand gold backing also increases. On August 8, 1922, the solid gold held by the F. R. Board was about £602 millions against £562 millions held in 1926. The ratio against combined deposit and note liabilities was about 77·8 per cent. America has become a long-

66 See Helffrich, "Money," Vol. II, p. 647.

67 The maximum production of gold was recorded in 1915 at 227 million fine ounces. The minimum was reached in 1922 when the output dropped to 15·45 million fine ounces. Since that time he points out that the tide has turned; the output for 1923 was 17 720 million *fine ounces* and for 1924, 18·826 million *fine ounces.*

For still more recent figures, see "The production of gold in 1932," by A. J. Zivadsedze, in the London Banker's Magazine, 1933.

68 They estimated that the price of silver would not be less than 45 to 55·6*d*. per ounce. Actually it was never higher than 43 per ounce thus falsifying their prophecy.

term capital providor while she borrows for short-term purposes. America is a great short-term debtor nation to the extent of nearly £400 millions. Any call of this gold would mean credit contraction, gold diminution and fall in commodity prices.[69] America's gold is susceptible to international influences and may be suddenly "vanishing" as Secretary (now ex-President) Hoover puts it.

It is not only America but each country has to protect the gold stock and the banking system of each country has to administer and protect the gold stock held by it. International financial machinery is being perfected by the Governors of the important Central banks of the world for the smooth co-operation on the part [70] of the different countries to meet this emergency. To be forewarned is to be forearmed and the joint efforts of American and London financial interests are to be exerted in the direction of stabilising the value of gold over a long period of time. A sort of financial League of Nations under the auspices of American and London financial interests has to be formed to solve the gold problem. Now that the Bank for International Settlements is functioning successfully this problem can be easily worked out.[71]

The Influence of Annual Gold Production.

The annual production of gold is an infinitesimally small portion of the total stock of available gold existing in the world. It is the existing value that determines the value of the new output, *i.e.*, expensive mines would be thrown out of production. Thus the ordinary doctrine of value, namely the cost of production does not govern the value of gold. The annual gold production does not affect the price-level even though it might be produced in large quantities. An appeal to history may convince the readers of the truth of the above statement. The stock of gold in the banks may be constant, yet the price-level may be rising. Witness the rise in prices of the U.S.A. during 1912,

69 See the Economist, Sep. 12, 1927.

70 ,, ,, ,, Jan. 14, 1928.

71 See my Elementary Banking, 2nd Edition, Chapter V, on the Bank for International Settlements.

1916, 1919 when the stock of gold was fairly stationary. So also the stock of gold might be increasing, yet no changes in the price-level may be noticed or they might not prevent a fall in prices as in 1920 and 1921 in the U.S.A. One important fact to be inferred is that it is the credit policy and the velocity of circulation of credit that influences the price-level during the short-periods.[72] This very action meant to stabilise the value of gold is essentially intended to stabilise its value over long periods of time. A deliberate policy to stabilise the value of gold can be pursued instead of leaving it to be determined by the combined forces of demand and supply and cost of production.

Suggested Remedies.

Very little energy has yet been spent in the search for methods of solving the problem other than those offered by reduction of reserve ratios or paring a little finer the gilt-edge of the gold paper, the economy of gold in actual circulation, the use of international securities as recognised means of payment, the pooling of gold in the hands of the League of Nations to settle international transactions or the starting of an International Institute of Credit. Public attention has thus far been drawn to those four or five expedients alone.[73]

Some uniform lower ratio of gold reserve to the note and deposit liabilities of the Central Banks of Issue can be adopted by International action. If gold is not to be adopted in circulation a lower ratio would not be found insufficient. Like the " buried corpse " the gold would be in the hands of Central Banks as an " ultimate safeguard " and reserve for " sudden reqirements." The essence of the idea is however to free the gold standard from the exclusive influence of gold stocks. The ratio is after all " a convention." Public confidence would not be shaken by such universal reduction of reserve ratios to total liabilities. The whole theory of reserves of Central Banks can be

72 As Keynes says," the price-level does not depend on the quantity of gold in the world but on the policy of Central Banks as regards their reserve proportion "—Tract on Monetary Reform.

73 It is a matter of gratification to note that the Gold Delegation Committee recommend the self-same measures.

briefly stated as follows: There should always be something in the reserve there and it is not also meant for employment all the time. Uniform bank money expansion in all gold standard countries can be carried to a limited extent to offset the diminishing supply of fresh gold and it is possible by this action to maintain prices at a steady level.

Coming to the economy of gold in circulation no country in the world not even Keynes's classical example of Egypt, is circulating gold to any extent worth mentioning. The gold bullion standard or the gold exchange standard are the chief variations of the gold standard which have been adopted by all countries which have resorted to the gold standard. The centralising of gold would tend to make it efficient and this economy in the use of available gold for monetary purposes is no less important than reducing the demand for gold for hoarding or industrial use. Gold is to be practically made dead for currency circulation purposes. There is nothing undignified if gold is not used for currency circulation. The development of credit on larger scale than at present would achieve this desired economy of precious metals. Every Central Bank should be empowered like the Bank of England to compulsorily acquire any gold bullion or currency not held for export purposes or bona-fide industrial purposes.[74]

The use of international investments would effect considerable economy in the international use of gold. If all countries absorb and hold such investments in sufficient quantity the payment of international indebtedness would be smoothly performed. The other capital-poor countries including India must learn the advantage of holding these international investments. It tends to the development of the world's clearing system.

The pooling of gold in the hands of a super-Central Bank of the League of Nations involves the maintenance of reserves abroad. Fortunately all this is now rendered unnecessary as the Bank of I.S. can now easily develop into a super-Central Bank. This is subject to disadvantage for a country possessing a favourable trade balance would lose much by placing its gold abroad. It is after all deprived of the advantage of real economy of gold. It would be far better to keep

[74] See Section II, Clause (2) of the 1928 Currency and Bank Notes Act of the United Kingdom.

it in the financial centres of the world for a prompt and ready use can be made.

Next comes the suggestion of an International Institute of credit which is not however to be considered a bank.[75] While admitting the efficiency of the above remedies attempts should be made in other directions also to solve the problem arising out of gold scarcity. It would add to the reader's sense of the urgency of monetary reform if I submit my view on the problem and its possible solution.

The Irving Fisher Method.

The gold bullion units can be made lighter to check the fall in prices resulting out of gold scarcity.[76] An international agreement in the above direction of reducing the weight of the different gold units by uniform percentages would be quite feasible. This would however make quotations of exchanges very difficult to unravel.[77] But Fisher's

[75] An International loan is to be floated by the International Institute of Credit for securing the necessary capital. It would give credit to all countries on proper securities up to the amount of their requirements for their balance of payments. A National Exchange Office is to be created in each country, to work in co-ordination with the Central Bank of Issue of the country and the International Credit Institute whose function is to work as an International Clearing House. By means of book transfers the International Institute of Credit can make large payments without the intervention of bullion. This national exchange office alone being empowered to operate in the credit it has to operate it for the express purpose of paying international indebtedness of the country. Adopting the principle underlying G. E. Standard system the N. E. Office can operate this credit by issuing gold bills at a fixed rate (export gold point) to individuals who have to pay their indebtedness outside the country. Similarly the N. E. Office has to fix the gold import point into the country and accept foreign gold at this fixed rate or to purchase foreign bills at this rate with internal currency. The main advantage of this scheme is the rendering unnecessary of gold shipments and substitute in its place the purchase and sale of foreign bills payable in gold at rates approximating to the gold points. The economy of gold underlying their plan cannot be disputed. The National Exchange Office can open branches in all trading centres and facilitate arbitration in agreement with the International Institute of Credit. The power to purchase private bills and sell them will facilitate the stabilisation process. This method of monetary reconstruction based on the principle of gold standard was first proposed by Luigi Luzatti in 1912 at the Brussels Congress.

See Bertrand Nogaro "Modern Monetary Systems," pp. 219-224.

[76] See Stabilising the Dollar, General Summary ; pp. xxvii-xxviii, would give a bird's eye view of the whole plan.

[77] See Keynes. "Tract on Monetary Reform," pp. 188-89.

plan involves the use of the Index Number which according to some economists such as Soetbeer, Porter, Sir R. Giffen and Mr. Sauerbeck is only a "rough indicator of the general trend of prices and should not be made the absolute guide or regulating basis of any monetary policy. Preventive action is necessary rather than ameliorative action. There is often a lag between credit changes and consequent effects on price-level.

Without gainsaying the fact that this scheme can do something to mitigate the slow changes in the value of gold from having their influence on the standard of value, it must be recognised that it is not a simple easily intelligible plan. The Index Number itself is not considered as a satisfactory regulator of values. Profs. J. M. Keynes and Pigou would recommend other indices such as the state of employment, the volume of production, the effective demand for credit as felt by the banks, the rate on investments of various types, the statistics of foreign trade and the level of the exchanges. This is too radical a plan of action and involves a change from the present gold monetary standard which has a fixed gold content.[79]

Draw gold out of hoards.

A campaign which tends to throw gold on the market would materially help the solution of this problem. Increased stocks of gold can be liberated. If India or any of these hoarding countries were to supply stocks of gold, an extensive use of cheques and other forms of bank credit should become popular and the banking habit should be implanted. Such a phenomenon was witnessed on a large scale during the war time when private hoards of gold were liberated and the reserves of Central Banks were doubled or even trebled. These Central Banks collected the gold as "backing" for the paper currency issued during the period. The diminished supply from the gold mines can largely be augmented by the liberated gold from private hoards in order to meet the demand for gold. This demand for gold would itself be lessened if gold coins are no longer used in circulation and the new

[78] Prof. A. C. Pigou, "Industrial Fluctuations," pp. 275-287.

[79] See Hartley Withers "Bankers and Credits," p. 249.

gold needed to fill the gap arising from the abrasion of coin would be no longer necessary.

But unfortunately the very discussion about scarcity of gold would tend to be canvassed far and wide and lead to further hoarding by the Governments, by banks and by private people, for they think it best to hoard a metal that is likely to rise in value. They would take advantage of its present cheapness which might not last in the near future. Dr. Marshall considers this tendency as the famous law of hoarding. He formulates it thus, " demand for a metal for the purpose of hoarding is increased by a continuous rise in its value and diminished by a continued fall because those people who hoard believe that what has been rising in value for some time is likely to go on rising and *vice versa*.[80] Effective checks against this public and private hoarding must be undertaken. A war chest is an instance of public hoarding. Unless the disarmament proposals are sincere this sort of public hoarding would go on unchecked. The banks can release gold stock now held as security for loans and this released gold can be used for monetary purposes.

Can we lessen the industrial use of gold ?

The consumption of gold in the arts would have to be reduced to a certain extent. But this would be difficult if there is gradual growth of wealth on the part of the people. As one economist puts it "gold is the satellite of man's ways and gyrations." It is difficult to order gold about and lessen one of its uses. Gold is considered as accumulated wealth economised by the people. This stored up energy is to be liberated in the purchase of consumable goods when desired. Such being the real reason it is not mere love of ornaments that can account for its extended industrial use.

International Fiduciary Currency.

International fiduciary currency notes not based on metal currency and circulating as legal tender in several important countries

[80] See Answer 5, Royal Commission on the Depression of Trade and Industry, 1886. This contingency is being actually realised during the years 1933 and 1934.

can easily be adopted as an international currency standard just as gold is being considered as an international standard. Gold is the international standard, as the currencies of several countries bear constant relation to gold and gold can be converted into legal tender money in all these countries at a constant ratio. Similarly international paper can easily circulate as money.[81]

The abstract idea underlying money and the standard is the " unit of account " conception. It need not essentially be a commodity like gold. It is only an " object " or " ticket " which enables the holder to obtain in exchange for it the commodities required by him. This is the exact meaning of the term money and standard. So a standard to become international need only circulate in a large number of countries and if it is issued in limited quantities it would constitute sound money.

The difficulties and dangers of international fiduciary currency are tacitly recognised by theorists as well as statesmen. Doubtless such a plan would not be accepted by intensely nationalistic states which may consider their insignia of sovereignty impugned to a great extent by the circulation of international fiduciary currency within the borders of their country. Unless a great degree of international co-operative action is forthcoming the scheme cannot meet with success. An International Bank issuing fiduciary currency with a stable relation to gold can be considered nothing more than as fine idealism for the present. Though theoretically sound it cannot be asserted that the world is either prepared to adopt this improvement or has perfected the technique of monetary management.

Resort to Barter.

Changes in methods of payment as resort to barter will have a profound influence in diminishing the demand for gold and the monetary service it has to perform. If only a money of account exists barter can be conducted in the modern days. The present-day

[81] Prof. Marshall says. " for current business money needs only to be clearly defined, easily handled and generally acceptable and that these conditions can be easily satisfied by anything which has obtained adequate prestige from custom or from the edict of a public authority even though it would be valueless but for this prestiges."

barter of modern international trade consists in changing goods for the money of account. If this enlightened system of barter were to be encouraged in the internal exchanges within the country the need for gold currency circulation or extended use of credit needing additional gold backing would be given up.[82]

Thus far[83] the remedies suggested fall under the headings, namely, the reduction of demand for diminished supply of gold and increase of supply from other sources to fill the gaps caused by diminished supplies of gold output from the mines. Again each method outlined above depends on the isolated action of each country and except in the universal adoption of Prof. Fisher's plan there is no presupposition of co-ordinated action on the part of the different nations.

Conjoint Action by Chief Gold-producing Countries.

It is theoretically possible to anticipate changes in the value of gold and correct them by intelligent action. A syndicate of [84] the chief gold-producing countries, namely, the United Kingdom and the United States of America which produce about 4/5ths of the total production of world's output of gold can undertake this co-operative action. There would be no difficulty in getting uniformity of action on the part of the small number of producers. The value of

[82] Such refined barter was practised to a certain extent in Germany when the printing press began to produce disastrous effects on the price-level " whirling it up in a mad witch's dance." A great portion of the business was done in currencies such as dollars and other foreign currencies but trade and business were conducted on the system of barter to a certain extent.

[83] The following theoretical defects against paper currency can be cited. "A currency without metallic backing will collapse. Paper leads to monetary hoarding. It upsets the internal price level more than gold. It encourages wild government finance. It leads to uncertainty and internal bad trade. Paper endangers the food-supply and reduces the financial earning of the City. Paper makes prices different in different countries. Paper fosters dumping by Eastern countries, with low-paid labour. Tariff's are bred by paper. Paper exchanges are at the mercy of speculators. Paper discourages international investment and world development. Paper by checking foreign trade encourages a wasteful economic nationalism." See L. L. B. Angas, " The Problem of the Foreign Exchanges " Chs. XV and XVI. But most of these are exaggerated half-truths and even the gold standard cannot remedy them. An inconvertible nationally-managed paper can secure some of the objectives of managed currency though not all of them.

[84] See Prof. Lechfeldt "Restoration of the World's Currencies." p. 56 and the following,

tobacco is regulated nicely by the Swedish government. The gold-producing Syndicate has to compensate the owners of mines out of its funds who would be forced to give up production of new gold when its value tends to fall as a result of increased supply with reference to the total demand.[85] As this is not likely to be the case and as demand for gold is likely to increase on the part of these countries which wish to give up the paper standard the total demand for gold would be very great and the long-distance course of prices would be lower or downwards. But if the prices were to fall slowly no action should be taken up by the gold-producing syndicate and it should be considered as a blessing for it would stimulate demand for industrial products and agricultural raw materials. But if the value of gold were to rise very abruptly it can be prevented by the gold-producing countries (syndicate) issuing paper certificates which would have to be considered as gold substitutes. This enhanced demand would be met gradually by increased production but gold production cannot be within the complete control of the gold mining syndicate. Mechanical progress and productive efficiency of mining labour so as to obtain gold even from the low-grade ore can be secured under the aegis of the gold-producing syndicate. It might discover new methods of tapping gold from the bowels of earth or " any chemical process which draws gold from sea-water." It can also enlist the action of the Central Banks to support it at this juncture.

Conjoint Action by the Central Banks.

The growth of co-operation among the Central Banks of the different countries can increase the efficiency of the credit system and the economising of gold for internal purposes can be secured. The development of paper money substitutes can be regulated. If the Central Banks can see that no undue widening of the gap between gold and paper is allowed and the different paper currencies and gold reserves have a proper relation to each other and to gold, the extended use of credit would bring salvation in the days of scarcity of gold.

85 Undoubtedly much can be done within the law to bring production more in line with consumption and this checks price fluctuations. This " sterilising " of gold by clever banking control is also feasible in the advanced credit societies.

Each country has to co-ordinate its requirement for gold with reference to the general position of gold in the rest of the world.[86] The late Governor Strong of the F. R. Board of New York has successfully inaugurated the policy of co-operation among the Central Banks of issue and if this machinery were to function continuously the future value of gold can be stabilised to a great degree. The gold standard must become the universal standard of value and the wider the use in which gold serves as a standard and is the principal monetary metal the less is the danger of a further fall in the value of the metal. The very cessation of inflation as a result of the universal restoration of the gold standard would mean lower prices and if costs of gold mining decline the production of gold might increase.

It is indeed true that a thoroughly perfect standard of purchasing power is unattainable.[87] It is only a comparatively rough standard that can be thought of and the international gold standard can secure this ideal better than non-metallic regulated and nationally managed paper currencies. By taking common concerted action on lines foreshadowed in the previous pages considerable variations in the purchasing power of gold can be eliminated and the future value of gold can be made a great deal more stable than without such common co-ordinated efforts in that direction. If instead of the old reserve-discount policy of the Central Banks or the creation of productive credit to satisfy every demand the price-stabilisation-discount policy coupled with other data for effective credit creation is pursued by the Central Banks of the gold standard countries the chief defects of the pre-war gold standard would be eliminated to a great degree.[88] The

86 As Harley Withers puts it, " Instead of each of the Central Banks pulling at the edges of the gold blanket they will have to work together to spread it out and smooth out the creases and make the most of it, "—H. Withers, " Money." p. 79.

87 See Dr. Marshall, " Money, Credit and Commerce," p. 28.

88 The theoretical defects of the gold standard are that it involves injuriously harmful violation of the law of supply and demand in the foreign exchange market It prevents the proper economic adjusment of the supply of internal money to demand. A stabilised gold standard is unsuitable to a capitalist country with a rigid inelastic wage and cost-level. It causes short-run trade fluctuations. It is one cause of the business cycle. Industry becomes gold-bound every few years. It spreads financial diseases internationally. But these theoretical defects can be toned down by intelligent anticipatory action on the part of the credit authorities.—See L. L. B. Angas, The Problems of the Foreign Exchange," Ch. IX.

price-stabilisation discount policy involves the changes in the discount rate as soon as a noticeable change in the following economic conditions is realised. Movements in the prices of speculative securities and all other prices, new orders given in the important industries or stocks of furnished goods in dealers' hands or percentage of work people out of employment and changes in the volume of credit, are to be employed as the desirable signals for changes in the price-stabilisation discount policy of the Central Banks. Such careful manipulation of the discount rate was successfully accomplished by the F. R. Banking system of the U. S. A. and even in pre-war England many of these changes were also considered as indices for variations of the Bank rate by the authorities of the Bank of England. Prof. Keynes wanted the extension of this policy into the field of non-metallic managed currency system proposed by him in lieu of the managed old gold standard system.

This is the ambition of the advocates of monetary reform who have recommended the restoration of the managed international gold standard. India and China should not lag behind the other countries in this direction. At last a Central Bank of Issue has been created and its sole aim should be currency and monetary reform based on a careful study of the banking habits and practices of the Indian people. The price-stabilisation discount policy cannot immediately be put into actual practice for the data on which the necessary alterations in the bank rate would have to be based are for the most part non-existing at the present time. There are no trade institutes to secure co-operation and run industries on economical lines. Nor does the India Government do statistical work on lines of the Survey of Current Business of the U. S. A. Federal Government. As the use of cheques is so very little the Central Bank cannot immediately hope to control credit and purchasing power so very easily as Central Banks operating in credit societies can hope to do. But it can hope to do something in the direction of controlling money rates in the important money markets where a short-term use of the floating balances of the banks is made.

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CHAPTER XIX.

Bank Organisation.

The Clearing House—The development of the cheque system-Branch Banking in the interior—Foreign branches—Bills of Exchange—Mechanisation of banking work and its possibilities.

The Clearing House.

In connection with the organisations which bring the different banks together, something has been said already of the Banker's Association and the Banker's Guild. The Institute of Bankers whose special object is the education of the bank staff has also been studied. The most important piece of banking machinery is the Clearing House. Of the early origin of the Clearing House system in India nothing definite can be stated. But the present-day Clearing House system that exists in India does business on the model of the English Clearing House. The English Clearing House may be defined as a device to simplify and facilitate the daily exchanges of items and settlement of balances among the banks. The Clearing House in America not only performs these functions and secure the well-known economies of time, labour and money, but it goes still further and acts as a medium for united action upon all questions affecting the mutual welfare of the banks. An ideal Clearing House has to serve as a constructive agency for settling the points of mutual interest.[1]

The American example.

In America some of the following functions are performed by the Clearing Houses.[2] They take up the question of extending loans to the Government. They fix the minimum rates of interest which the

[1] See J. G. Cannon, "The Clearing Houses," p. 11.

[2] It has been reported that an informal gathering of all the jt. stock banks was held at the suggestion of the Imperial Bank of India to co-operate with each other and make the 1928 Rupee loan of the Government a success. If an efficient Clearing House system were to exist in other centres also even a *pro rata* distribution of the loan among the different banks can be undertaken and the loan can be floated on the money market with the least apprehension.

banks pay to their depositors. They fix uniform rates of exchange and charges of collections. They hold an independent system of bank examinations. They issue Clearing House Loan Certificates to the banks doing sound business on good assets and on the strength of these certificates these banks can borrow. It was by means of this device that the American National Banking system tried to remedy the defects arising out of the absence of a Central Bank. As R. G. Hawtrey puts it, " this process was a rudimentary analogue of the rediscounting facilities given by the great European Central Banks. It was an expedient born of sheer necessity and was itself an evidence of the urgent need for reform."[3] The Federal Reserve Act introduced not only a system of rediscounting approved commercial paper as in the case of the European Central Banks but it has revolutionised the old, ineffective, expensive and cumbersome system of clearing cheques. Prior to the formation of the F. R. System the various sections of the country were not served by a single set of clearing institutions efficiently co-ordinated and systematised. The indirect routing of distantly drawn cheques meant long delay in securing the return of cheques to the drawn bank. The F. R. system has instituted a countrywide par collection of cheques and member as well as non-member banks are included in this business. With minimum cost and physical effort domestic transfers of currency are taking place as a result of the institution of the Gold Settlement Fund in New York.

The European Continent.

On the European continent the Clearing House system has recently been started. It does not play such an important part because all the countries possess a centralised banking system, possessing a large number of branches. These Central Banks do a large business in current accounts and the transfer and remittance of funds are accomplished largely by cancellations through book-entry.

The Present Situation in India.

Unfortunately for us we have neither a responsible Central Bank nor an efficient, enterprising and go-ahead Clearing House system as

[3] See R. G. Hawtrey, " Monetary Reconstruction," p. 94.

they have in America. If the Reserve Bank is able to throw open rediscount facilities to all the important banks, the privilege of being on the rediscount list would be almost as much coveted as the privilege of being a member of the Clearing House. The Reserve Bank should scrutinise the position of all the members on the rediscount list now and then and weed out all unsound concerns from its list. This itself acts as a most salutary check forcing the ordinary banks to conduct their discount business on scrupulously clean lines and helps us to improve the banking standard. Such an extension this of privileges would lead to closer co-operation between the Indian joint-stock banks and the Reserve Bank. It is only by an extension of this privilege that the Reserve Bank can extend accommodation to meet the growing needs of traders in India. A trader's bill bearing only one signature is never discounted by the Central Banks. The same should be the case with the Reserve Bank of our country. Hence there should be an intermediary to enable the trader to obtain the needed accommodation. There would be no greater and more secure intermediary than a joint-stock bank and it is only through the banks that accommodation will reach the mass of traders.

The importance of rediscounting.

Another grave reason why the rediscounting of commercial bills should be an important feature in the case of our Indian banks is that those do not generally possess ample financial resources. They do not attract much of deposit money hence there is no reason why the bank should be hindered from supplementing their resources by having access to the Reserve Bank.[4] It should be considered a legitimate branch of their business. So long as these banks maintain a ridiculously small reserve simply because they can augment their capital by rediscounting the bills easily there is nothing opposed to sound

[4] In the continental countries the smaller banks have access to the Central Banks by the rediscounting process and they are able to do much service to the trade and industry of those countries. In England the rediscounting of bills by the smaller banks is not liked by their customers who object to their paper being "peddled about."

principles. Rediscounting is the only safest and cheapest method of placing credit facilities in the hands of smaller banks. Without a Central Bank of Issue these rediscounting facilities cannot be secured. So long as the Central Bank of Issue is not created there is ample necessity for creating the process of borrowing on Clearing House certificates. Taking the case of the recent winding up of the Bombay Merchants' Bank we find that it has been solely due to the locking up of 16 lakhs worth of assets in 16 lakhs worth of liabilities.

The Number of Clearing Houses.

There are about eleven Clearing Houses in all, Calcutta, Karachi, Bombay, Madras, Rangoon, Cawnpore, Lahore, Amritsar, Ahmedabad, Delhi and Simla. The Imperial Bank of India facilitates the clearing business in all these places.[5] More city Clearing Houses should be started and one such ought to exist at Lyallpur, Lucknow, Rawalpindi and Allahabad. The Imperial Bank has a branch operating in these centres. It should take the lead and start the Clearing House organisation in these centres though they ought to be working under the management of the Reserve Bank. The Imperial Bank has a branch operating in these centres. The private bankers should join the Clearing House organisation in order to increase their utility. The endeavour should be to link up all the various sections of our country and serve them by a unified and nationwide system of clearing cheques efficiently co-ordinated and systematised under the Reserve Banks' management as soon as it is undertaking this function. Even in a metropolis like Calcutta all the banks in the locality are not sometimes included in the local clearing system. This means the possibilities of setting off debits against credits are limited when

[5] Cheques drawn in the Imperial Bank of India by other Banks are not universally passed through the Clearing House. In Bombay the practice of the Imperial Bank is to deal with such cheques direct so that the figures of banks are to a certain extent lower in proportion to the total amount of transactions than they are elsewhere.

See p. 19—Report of the Controller of Currency (1926-27).

the system does not embrace all the banks which generally receive and collect each others' cheques.

At present "out-station" cheques are not cleared through the Clearing Houses. The latter have to be sent direct to the paying banker through agents or branches. This involves undue currency movements. The best way to mitigate this is to start Provincial Clearing Houses under the management of the Reserve Bank and permit out-station clearing of cheques. Inter-provincial clearings should also be facilitated on the lines of inter-district and intra-district clearing work done by the F. R. Banks in the U.S.A. Until such a plan is instituted cheques on the country banks would not become easily acceptable as cheques on the City bank.

The increase of Clearing House figures is often interpreted as a sign of trade activity and economic progress of the country. But much caution is needed in interpreting these figures. Even in a progressive country like England where 98% of payments are made by cheques the people are careful in interpreting the figures. Increase in clearing business may be due to special activity like speculation on the Stock Exchange. For instance the figures of the Town Clearing of the London Clearing House are largely influenced by financial transactions. Metropolitan and country clearings are better guides for trade conditions. Metropolitan figures indicate the retail business of the metropolis and the country clearing figures indicate the general trade conditions. Coming to our Clearing House in Calcutta speculative activity is sometimes responsible for high figures. On the whole the prosperity of the jute, tea, and cotton industries and business conditions does get itself reflected in the Clearing House figures. Slackness of trade and depression in any industry and decreased activity in share transactions and stopping of the sale of gold or reverse council by the Government contribute towards checking the growth of clearing house transactions.

The Development of the Cheque System.

The machinery through which the modern cheques are cleared has been studied in detail. The cheque system is not greatly in vogue. It is indeed true that an increasingly large number of cheques are

passing through the Clearing House daily as the following table illustrates it.

In Lakhs of Rupees

Year.	Cal.	Bom.	Madras.	Karachi	Rangoon.	Cawnpore.	Lahore.	Total.
1914-15	26695	15783	1881	1162	4312	—	—	49833
1919-20	105576	88302	3395	2313	9474	—	—	143219
1924-25	95411	62166	5596	4613	11721	572	557	180636
1925-26	101219	44505	5680	3614	12533	616	686	168853
1926-27	96101	42268	5453	3107	12442	816	770	160957
1927-28	105402	38980	5979	3082	12557	700	759	167459
1928-29	109400	65235	6523	2802	12500	731	869	198110
1931-32	73109	62382	4397	2323	7890	563	902	151566
1932-33	79037	66742	4885	2556	7075	708	850	161853
1933-34	83088	65547	5319	2678	5612	888	988	164120

(See the Report of the Controller of Currency, 1933-34, p. 75.)

A glance at the above table[6] shows sudden increase of transactions in 1919-20 and 1920-21. This was due to sales of gold and of reverse councils by the Government ; payment being made in cheques. Clearing House transactions were on the increase. In addition to these reasons there was great slackness of trade and increased activity in share transactions. Again in 1926-27 there was a drop in Calcutta and Bombay centres due to the business recession and the lowered prices of export staples. The steady increases in the clearing figures of Cawnpore and Lahore speak of the growing popularity of the use of cheques in the mofussil. Another lesson to be drawn from the 1927-28 figures is that there are changes in the procedure of the Clearing Houses at the different centres. When compared with

[6] The above figures and explanation are taken from the Annual Reports of the Controller of Currency. For recent figures the Statistical Tables relating to Indian Banks may be consulted.

Calcutta figures the Bombay ones are not so high. It does not however mean that there is less business activity in that centre.

But there is no widespread use of cheques as in the English [7] and the American banking systems. It is the English banks that have been encouraging the use of cheques on the European Continent. The Paris branches of the English banks issue cheque books to their customers containing full instructions including a specimen drawing and crossing inserted in the book and the merchants and private individuals are now making a greater use of the cheque instruments in the matter of payments.

So far as India is concerned the use of cheques is confined to the Presidency Towns and other big commercial centres and European merchants alone make a free use of these cheques and the development of country clearing in the matter of our cheque system will undoubtedly increase their popularity. The educated classes are slowly acquiring the habit of drawing cheques for large payments. The Government of India is also doing something in this direction. Sanction has been granted under certain conditions to the payment of land revenue by a cheque on the Imperial Bank of India. But very few people are in a position to take advantage of it. As in England cheques are not drawn for small amounts.

The cheque is looked upon as a thing so distinctively British as to be called by the late Lord Avebury "The Union Jack of Commerce." The cheque has invaded the domain of the bank note and the bills to such an extent that Mr. (now Sir) D. Drummond Fraser says that "the cheque has hurled the note from the pinnacle of its power." Before the recent war cheques were always drawn for high figures, say—three to five pounds. When the scarcity of silver sent up its price to an unprecedented height and when the intrinsic value of the shilling coin became higher than its

7 The growing use of cheques for financial transactions is mentioned in the annual reviews of Bank Clearing House. This is despite the fact that the cheques have now to bear a two-penny stamp instead of a penny stamp as in the pre-war days. It is pointed out that the yield to revenue of the two-penny duty on cheques for England and Wales has steadily increased in the last five financial years from £ 2,504,000 to £ 3,181,000. The latest return represents approximately the cheques drawn per annum per head of the population. English women have bank deposits for their dress allowances and the payment of household bills.

nominal value an increased use of cheques and paper currency was made even for very much low denominations as crowns. Owing to the financial necessity of war an increased stamp duty was levied on cheques but the popularity of cheques was in no way diminished.

Our people should realise the advantages of cheque currency, the cheapness, the ease and economy that arise out of its increasing use. Well devised cheque currency is the most elastic thing of its kind. A simple and suitable cheque system dispenses with the use of currency which might thus become available for the purpose of credit. The development of the cheque currency renders the metallic currency a matter of altogether secondary importance.

Obstacles in the path of cheques.

The following facts stand in the way of the popularity of the cheques. They have to be drawn up in a foreign language and a single erasure or mistake would lead to its refusal. Many of the Indian banks insist that the Rs. 25 limit should be adhered to, *i.e.*, cheques below that limit cannot be drawn. This figure is too high for many of the Indian people whose standard of living is very low. The characteristic of the Indian people which has distinguished them from time immemorial is plain living and high thinking. The sole object of the unsophisticated Indian mind is to secure a better and purer life by resorting to simplicity in clothing and food, sincerity in thought and deed, sweetness in disposition, fortitude in suffering, moral excellence in face of trials and temptations and abiding capacity for endurance and sacrifice. So long as this tends to make the standard of living simple and unostentatious the payments to be made, though they be many, do seldom come up to the required limit. Hence cheques are not increasingly made use of even by the educated people possessing a banking account.

Again the cheques are to be drawn in a foreign language and as it is a comparatively small part of the population [8] that is in a

[8] A reference to the Statistical Abstract shows the literate element in the different provinces. The conception of literacy according to the census authorities is indeed a crude one and one who can read and write is considered as literate. Hence the English knowing and writing people might be actually smaller than these figures.

position to correctly draw it up in the English language the use of the vernacular on the body of the cheque might lead to its greater popularity.[9] The stamp duty on cheques has been removed.[10] Although the Provincial Governments have done their part of the duty in a satisfactory manner the banks have to play a more prominent part in the popularising of the cheques and even the Imperial Bank's common charges for collecting cheques drawn on other stations are very heavy and that of other banks is only triflingly less heavy. Some of the Indian joint-stock banks might permit the drawing of cheques against the Savings Banks deposits lying with them. There is no reason why this facility should not be granted when specially some of the foreign exchange banks grant this privilege.

India is a land of men of small means and of small transactions and too much use cannot be expected out of these cheques. As Hartley Withers says, " the extensive use of cheques is possible only in a community which has reached a high stage of economic civilisation and is also blessed with a high level of honesty among its members." In India the stability of Government, *i.e.*, political security and an efficient administration of justice exist. But a high code of business morality, increasing density of population, mutual acquaintance, better understanding, continuous production, frequent and regular exchange operations and better accessibility of the banks will bring about a better development of the deposit and cheque system. In short, the widespread use of cheques depends on the economic prosperity of the

9 The introduction of printed cheque books in Tamil by the Indian Bank, Madras, is an innovation which should be copied by the other Indian Banks. In actual banking practice there are several difficulties placed in the matter of vernacular cheques. Many of the banks require that the customer should sign the cheque forms in their presence and fill the date, amount, etc. at the time of negotiation. In case of female "signatures" a countersignature by a Magisterial Officer is insisted upon. The Imperial Bank generally does not encourage vernacular endorsements at the back of the cheque.

10 The real objection against the removal of the duty is the possibility of an undue multiplicity of charges for small sums and the consequent trouble in the process of clearing. There are not however insparable difficulties and if the people are taught the right use of capital at the right time there would be no danger resulting from this reform. Fortunately better sense prevailed and the stamp duty has at last been removed.

The United Kingdom would do well to copy this procedure and reduce the 2 *d.* stamp duty on the cheque. Otherwise "chequelets" or some other device would be adopted to foster the use of cheques for small amounts and thus encourage the development of banking among small depositors.

people and a large number of the people becoming the customers of the banks. As individual payments become larger and larger the use of cheques becomes substantial. The abolition of stamp duty would certainly attract more deposits for the banks and though transactions in petty amounts might be multiplied any clogging of the machinery of the clearing house need not be feared. As cheque payments become large the question of uniformity of size would crop up and every attempt should be made to print cheque forms of a uniform size so that there is convenience in handling, machining and sorting these cheques.

Branch banking in the interior of the country.

It has been stated already that branch banks should be started so as to extend banking facilities into the interior.[11] But every economically advanced country has accepted the policy of branch banking as the safest possible means of expanding the utility of their progressive banks. Alexander Hamilton has been credited with the honour of being the originator of this branch bank question. Canada took it up. Both in Australia and South Africa there is a highly developed system of branch banking. It has become a settled fact and one finds it thoroughly established in the United Kingdom [12] and the continental

[11] Manu Subedar has indeed dwelt at length on this issue in the Minority Report. He inclines to the opinion that small local banks would be preferable to branches of big banks in the matter of banking expansion in this country. That "local banks" tend to encourage the local borrowers, that local banks can be easily started with the help and guidance of the staff of the larger banks, that local banks can be run on economical lines and that banking progress of other countries "has been secured by means of small local banks and their extension," are the chief reasons advanced by him

[12] It is stated that every week-day in England a bank or a new branch of a bank is opened for business. The following statement gives the readers an idea of the extension of the branches by the "Big Five" of London.

Name of the "Big Five."	No. of branches. 1920.	1927.	1928. (Jan.)
Midland	1,483	1,953	62
Lloyds'	1,500	1,700	50
Barclay's	1.506	1,920	26
National Provincial ...	880	1,200	29
Westminster	789	957	18
	6,158	7,755	185

See the Mysore Economic Journal, January, 1929, p. 34.

countries.[13] But for the fact that the national banking law of the U.S.A. has prohibited branch banking [14] and that some of the various state laws do not encourage it would surely have spread itself there also. With the passing of the F. R. Act of 1913 a change has come over the situation [15] and the National City Bank of New York is organising its foreign branches systematically. Even the F. R. Banks are now allowed to have branches in their districts. Owing to keen competition on the part of the State banks there is a widespread belief that the only way of helping the National banks of the U.S.A. out of the situation is to allow them to extend their branches in those states where the privilege of branch banking is allowed. The provisions of the National Bank Law are also being made more liberal than before with the view of preserving the National Banking system as a whole. The main [16] lesson that we learn is that the evolutionary development of international banking and the branch system gradually dispenses with the services of the intermediaries and leads to greater and all-round financial strength, efficiency and responsibility.[17]

India ought to learn and profit by examples set by other countries. All the sound banks doing business on conservative lines should be made to extend their branches into the interior and establish a net-work of banking establishments to serve as connecting links between

13 The policy of the German Bank is very progressive in the matter of branch banking. In addition to their Head Office they have "filiales" or branches. They have also "Komman. diten" that is silent partnerships in private banking houses supplying them with capital. They have also 'depositen Kassen' or deposit office in all German cantons. Originally intended as deposit branches they have now become complete banking institutions by them-selves helping parent banks to bring an increasing circle of clientele and help the issuing power. It also extends the cheque, giro and clearing business of the parent bank. *Vide* Dr. Raisser, " The German Grossbanken."

14 *Vide* H. P. Eckhardt, " A Rational Banking System," pp. 1 to 7.

15 The growth of the National Banks is not the same as is the case of the State banks and about 176 national banks have surrendered National Charters to work as Stats Banks under State laws.

16 At the present time in the U.S.A. there are 28,468 National and State Banks and only 681 of them have branches. The Macfadden Act of 1927 governs the extension of branches by the National Banks. A branch can be opened by it only if the State laws permit such a thing and only if the municipality has a population of at least 50,000 and even then one branch alone can be opened there and two branches can be opened in the area of the municipality if it has not less than 100,000 people.

17 See my Elementary Banking, 2nd Edition, chapter on *Banking Stability.*

the various parts of the country. The starting of new banks is a difficult affair and whatever might be said in favour of independent local banks the verdict of experience, specially in the United Kingdom and Canada, has gone against it and the branch bank system has come into vogue.

The opening of branches will afford an outlet for the surplus capital at the head office and minimise the danger of its being invested in hazardous undertakings. They afford facilities for the transmission of money from one place to another and can easily bring about a proper distribution of capital according to relative needs of time and space.[18] Uniform interest rates can thus be easily secured. The small traders can be educated as to the advantages of a banking account. The branches will afford the best possible professional training ground for young people desirous of a new career. Expenses of management can be economised. The opening of branches all over the country would lead to an elimination of the banking risks involved in financing industries to a great extent. A branch bank can spread its loans over several industries which an independent local bank cannot hope to do.

It will lead to an increase of banking funds.[19] The various branches will give ample facilities for gaining accurate information of the credit standing of the customers. The branch bank system can be easily extended to places too small to support a regular bank which requires a full complement of officers and reserve of coin. A unified policy is possible during periods of emergencies. The system of clearing would become simple and effective. A greater use of cheques might also be expected.

But there are some disadvantages of the branch bank system. Each branch is a source of weakness and loss at one branch may lead

[18] Sir Basil Blackett echoes the same opinion when he says " that the steady extension of business of banks conducting business on sound lines leading to the extension of banking facilities will provide one of the promising prospects of eventual relief from the difficulties of seasonal monetary stringency."—Speech while opening the Central Bank's Calcutta Branch.

[19] " The deposit habit " as Bagehot says, " is a very difficult thing to begin because people do not like to let money out of their sight without security, still more cannot all at once agree on any single person to whom they are content to trust it unseen, and unsecure." But a branch of a big city bank conducting business in their midst effectively dispels this suspicion from their minds.

to a run on the whole establishment of which the branch is only a part. The branches may tend to rival the older establishments of the place, if any, and this rivalry may lead to the lowering of the banking standard. There may be a falling off in the nature of securities against which banking accommodation is sought and overbranching may lead to overbanking and the extreme rigour of modern competition will force the numerous branches to tout for unsafe and risky business. An undue and disproportionate multiplicity of banks will be co-existent with a tendency to indifferent banking finance. Small independent banks may be driven out of existence. Too many branches and all of them working under rule of thumb methods will tend to stifle intelligence and the branch bank system might tend to remove superfluous capital from the provinces into the metropolis and then the provinces might view this draining away of money with disfavour. Delay in the matter of granting loans would result to a certain extent as there is the necessity for reference to the head office while sanctioning a loan.

Many of the above-mentioned disadvantages are not inherent in the branch bank system. Nor are they the inevitable concomitants of it. Most of them can be eliminated by instituting a system of effective audit and insisting upon weekly reports of business from the heads of branches to the head office. There should be a clever training imparted to these officers at the head office before they are sent out as heads of branches. An efficient peripatetic supervision [20] by the manager of the head office would obviate many of the above defects. Some of the directors should make unexpected visits at the branch offices to see the way the business is conducted. If the branch banks are established in response to actual demand, if they follow strictly the legitimate duty of attracting deposits, if they confine themselves to mastering the credits of their customers, if they keep down expenses to a proper level and if they eschew all rivalry with the existing older banks and be amicable with new rivals that may enter the field, there is no reason why they should fail and cause ruin to the parent bank. Local businessmen may be appointed to advise the branch

[20] There should be a chief inspector for each large bank and these inspectors must issue confidential reports as to the state of banking business conducted by the branches.

managers as to the granting of loans and to study the needs of particular localities and gauge the personal credit of the customers of the bank. Reasonable allowance of power and discretion of action should be allowed to branch managers who may be induced to identify themselves with the people of the locality by their activities and pursuits. Frequent changes in the personnel of banks would give no scope for the perpetration of fraud on the part of the bank officers. If the above injunctions are strictly observed by the branch managers the branch bank system affords the best solution of increasing banking facilities in any particular country.[21]

Special Circumstances of India.

Although the salvation of India lies in this particular direction several well-informed people consider that a rapid increase of branches can never take place as there is a pitiable dearth of trained banking employees available to work these branches satisfactorily. Some are of opinion that it is of no use to merely increase the number of branches so long as the present psychology of bank depositors continues unchanged. The first breath of ill wind scares away the Indian depositors and a convincing testimony occurred so recently as in the case of the failure of the Bengal National Bank.[22] The late Sir Bernard Hunter said long ago that the Indian customers go in to the branches only for loaning purposes. As the inflow of money is not very substantial the branches act only as an outlet for the remunerative employment of the parent banks' loanable resources and not as feeders to the slender resources of parent banks. The question of expense has also to be reckoned. At least five to ten years must elapse before the branch can be made to pay its own working expenses.

21 The wastes arising out of competitive banking can be controlled by efficient supervision at the head office and the main aim of the management of the head office should be to abolish preferential treatment to few favoured customers and high rates in established centres of business to counteract the low rates in undeveloped regions.

22 The depositors of the different loan offices of the Bengal Province began to feel the pressure of the depositors' call and the Federation of the Bengal Loan Offices was more or less a defensive action on their part to strengthen their hands at such time when the depositors become unreasonable and insist on the prompt repayment of the deposit.

Mr. M. M. S. Gubbay says, " that branch banking is impossible as sound and liquid investments are not to be had in the interior and the branches cannot hope to utilise their working capital in sound conservative and automatically self-liquidating investments."

Actual Practice.

Coming to actual practice one finds that the branch bank tendency has taken root in this country. Owing to the mammoth expansion of the Imperial Bank and the recent bank failures the managers of the indigenous banks are diffident as regards the policy of branch expansion.[23] No doubt these conditions will soon pass away but the lack of *trained* banking employees to work the several branches is a real obstacle in the path of extension. This absence of trained bank officers has been chiefly due to two reasons. It is only the European people who have monopolised the banking business as their avocation and few qualified Indians aspire to have a successful banking career. The unsympathetic attitude of the managers of the immigrant banks is partly responsible for this state of affairs. While the European officers are shifted from department to department to grasp their routine the Indian officer has to literally rot in one department before he can obtain the opportunity to master the work of another department. The unconscious stifling of all chances and narrowing the scope of his vision have tended to deaden his faculties. It is a matter of poor consolation to record that " only eight officers have been allowed to rise from the ranks " and undertake the management of the newly erected branches of the Imperial Bank of India.

[23] The following table shows this tendency clearly :—

	Name of the Bank.	Branches (including agencies).	1925.
1.	The C. B. of India, Ltd. ...	... 16	17
2.	The Punjab National Bank	... 25	34
3	Bharat National Bank ...	... 6	5
4.	The Poona Bank ...	... 6	Closed
5.	The Bank of North India ...	... 5	Closed
6.	The Indian Bank ...	... 4	5
7.	The Bank of Mysore ...	... —	9
8.	The Bank of Baroda ..	... —	15

As regards the psychological objection it must be remembered that financial confidence is a plant of very slow growth and needs careful nurturing. It is barely a few years since our Indian banks managed by Indian officers have been conducting business. Mutual confidence between the bankers and the public is only a question of mutual sympathy and general prosperity.

Coming to the argument of the late Sir Bernard Hunter it must be noticed that it is not a serious objection to the starting of branches. Only he has advised caution on the part of bankers who may be anxious to increase these branches out of all proportion to the loanable capacities of the banks. When requested by the late Sir David Yule to reorganise the Alliance Bank of Simla his first advice was to close some of the branches which were not earning any amount of profit.[24] Any dissipation of the bank's reserve in several places would tend to increase the vulnerable parts of it in its armour. It must have been this argument that must have prompted him and other founders of the Imperial Bank to refuse to accede to the wishes of Rai Saheb Seth Nathmel who wanted the Imperial Bank to establish its hundred branches in places which did not possess any banking facilities. As a banker's bank its position must be impregnable.

Neither is Mr. Gubbay's objection a formidable one. The branches would have to lend on the general credit position of the borrower and even in case of internal bills the attending documents would not be forthcoming. In America, England and on the European Continent such domestic bills are discounted freely by the banks when they are satisfied of the genuinenass of the transaction which has given scope for the creation of the bills. With the help and co-operation of the shroff such bills ban be secured easily and if the banks can secure a central rediscounting agency these bills can be easily drawn in a form acceptable to the banks. It is the duty of the banks to accumulate a

[24] See Sir David Yule's speech to the shareholders of the Alliance Bank of Simla at their annual meeting held on August 1922. A reserve for branch banking can likewise be accumulated and though it would prove a burden on the general profits in the beginning yet in the long run it will enable the banks to extend branches and help the general economic development of the country. The People's Bank of Lahore had 80 branches ; the Alliance Bank of Simla had 51; the Tata Industrial Bank 126; the Industrial and Exchange Bank of Bombay 40; The first two banks have failed. The third amalgamated itself with the Central Bank. The fourth has recently suspended payment (March 10, 1924.)

reserve as a provision against bad and doubtful debts and as an equaliser of dividends.

But the remarkable pity of the present situation is that branches are not established in places which do not possess banking facilities but only in district capitals, populous towns and the chief monetary centres where banks already exist. Banking facilities should be extended into the interior of the country. The small agriculturist, the petty artisans and the local traders are those who are the chief sufferers and our banks should by extending their deposit discount and loaning functions spread a useful fringe of benefits over the entire community and protect it from the capitalist money-lending traders. The report on the Moral and material Progress of India [25] says " there are at present in all India under hundred head offices of the banks with 322 branches. The proportion of the total towns in India with a population of the thousand and over in which banks and their branches are situated is still only 25 per cent." The following table gives us an idea of the joint-stock banking institutions of the following countries.

	India.	The United Kingdom.	The U. S. A.	Canada.	Australia.	Japan.
No. of Jt. St. Banks	74	20	27,000	14	18	1,585
Branches.	500	9,381	...	4.000	2,795	4,000

The private bankers, *i.e.*, the Marwari banker and other indigenous confreres of his, carry on a lot of banking business but no statistical information can be obtained as to the number of their agencies and branches. Making due allowance for them one does not find that branch banking has progressed very favourably in India. It has been estimated that no less than 9,457 banking offices exist in the United Kingdom and although India is nearly 15 times greater in area and seven times larger in the matter of population than the United

[25] India in 1921-1922 edited by L. F. Rushbrook Williams. The situation is still the same. We have only 100 Indian jt.-st. banks with about 500 branches. This does not reckon either the Imperial Bank and its branches, the Exchange Bank and their branche and the private bankers and their establishments.

Kingdom one notes that it is seriously underequipped in respect of her banking institutions. In Scotland one finds that " every village has its own bank." MacLeod says, " What Nile is to Egypt so is the banking system to Scotland, a fertiliser." Happy would be the day when each big Indian village would be in a position to boast of its own humble banking office. At present many a town [26] with a population of 20 to 40 thousand inhabitants goes without even a branch bank whereas in England " every town with a population of 20 thousand people has been over-banked." In many places the starting of a branch bank is viewed with apprehension and every attempt to tout for business is deprecated.

Unfortunately the case is not so with India. In the first place there are not many big banks conducting business on sound and conservative lines, the Imperial Bank and the Exchange Banks excepted. The rest of the banks with the notable exception of the Allahabad Bank are new-born institutions and the crisis of 1913-15 mercilessly weeded away the speculative and the less stable of the Indian jt.-st. banks. Most of the banks are labouring under the difficult and slow process of building up their business but it is apparent that the existing number of banking offices are totally inadequate to meet our growing needs. As the Indian Industrial Commission says, " the banking facilities are purely non-existent to the major part of our population."

But a far greater number than the existing branches are required. In short the crux of the situation lies in the attracting of more capital to the vaults of the banks. This should be done by increasing the authorised capital after getting the necessary legal permission. Our old and well-tried banks which have borne the scrutinising tests of time and have come out purified and strengthened by the ordeals of several crises should extend their branches. It would be extremely unwise and dangerous to entrust our deposits to new banks whose integrity has not been proved, whose stability has notbeen put to the test and whose solidity is still a matter of doubt. These will be subject to all the ills of infant banking and India can ill afford to lose the

[26] The Government of India looks forward to the establishment of a branch of the Imperial Bank in every district and every town of importance. Roughly speaking there is at present one banking office for every 900,000 *persons in India.*

little capital she possesses. The next phase of development in our banking business would be the financing of our country by means of a well-devised system of branches strategically situated so as to tap the deposits of the people and minister to their economic needs wisely and beneficially.

While in Western countries attention has been drawn to the branch bank *versus* the independent local bank controversy in India on the other hand some ignorant persons find an apparent conflict of interest between the branch bank extension policy and the development of the urban co-operative banks. Mr. H. Duprenex and Sir J. C. Coyajee have been the staunchest exponents of the Urban Bank's extension policy. Both of them realise that the joint-stock banks are handicapped as their foreign managers find it difficult to expound their branches and gauge the personal credit of local customers. This is the real limitation to the development of the immigrant banks in the country. Hence Co-operative Urban Banks should be started to mobilise the unorganised capital in the interior, to provide financial facilities for the small industrialists and the artisans, to familiarise the people with forms of credit such as notes, cheques, hundies and bills of exchange and give them sound education in the matter of paper currency circulation.

But there are certain difficulties hindering the growth of the Co-operative Urban Banks. The want of leadership, lack of true co-operative spirit, the spirit of commercialism, lack of adequate financial facilities, lack of capable management, and a wide difference in the moral outlook of the townspeople are some of the chief difficulties and they have not increased to such an extent as the agricultural credit societies though both have been started at the same time. It is only in Bombay, Ahmednagar, Poona, Belgaum, Dharwar, Calcutta, Chittagong, Mymensingh, Pabna, Jalpaiguri, Madras, Chinglepet, South Canara and Salem that one really comes across progressive Urban banks.[27] As the bonds and bases for co-operative union are so very many in our society even this little success has

[27] There is a table showing the progress of the Provincial and Central Co-operative Banks and Urban Co-operative Credit Societies with limited liability and a capital and Reserve amounting to one lakh of rupees and above. As in the case of the Indian jt.-st. banks the Statistical Department has introduced a classification and all urban banks possessing 5

been rendered possible. The great sociological factor, caste, has been contributing to their success. Moreover the failure of the "mushroom" swadeshi banks has given a decided impetus to their growth. The different Railway Employees' Co-operative Urban Societies have also been flourishing mainly due to the privilege of deducting loans at the source out of the borrowers' salary.

But much more real work can be done by utilising the machinery of committee management as in Italy and employing banking officers or trained members of the Indian Co-operative Service as secretaries of the urban banks. It is only by these co-operative urban banks or by a development of the branch bank system that banking facilities can be organised. Till then "the Indian people will be minus all that makes the wheel of life turn smoothly, minus water, food, clothes, oil, sanitation, doctors, medicine, and education. These are chiefly traceable to that vacuum in the body public, *viz.*, the banking system for which India so wearily waits." [28]

Foreign Branches.

The scope of the Indian jt -st. banks must expand and they must accomplish more to-day than what they have been doing in the past. The vital need for the future is to establish such banking institutions as would render all the services which a customer would require whether in this country, or elsewhere without " splitting " up his account. With a growing population and ever-increasing manufactures and trade it requires an expansion in the outlook of the bankers who shall not be hampered by restrictions in the available quantity of banking resources.[29]

lakhs and over are classified in Class A and those possessing 1 lakh and over and below 5 lakhs are placed in Class B.

28 See Sir Daniel Hamilton's Essay on " The Policy of Development " in the Indian Co-operative Studies, p. 255.

29 Under their guidance and advice they must venture to trod the hitherto unbeaten tracks and finance the petty artisan and the small trader.

It is not only in their own country that the English and German Commercial banks try to establish their branches but they attempt to establish themselves in the chief monetary centres of the world. Failing to establish a foreign branch they at least make some working arrangements with a foreign bank. The practice of holding shares in foreign banks has become an established fact in the English banking system. During the war the first purchases of Irish banks were made. Scottish affiliations were then taken up. Many of the English Banks combined to have a foreign bank or attempted to hold a controlling interest on a large-scale in various colonial and overseas Banks.[30]

Some of our banks must be international banks thoroughly organised and do business of an unimpeachable type. Our growing trade with Japan and America is becoming an established fact and foreign branches at Tokio and New York will not fail to be advantageous concerns.[31] At least international alliances should be formed. Foreign institutions are encroaching a bit too freely on our domestic business. The interests of Indian businessmen would be better served if "*all-Indian*" banking facilities can be afforded.

The advantages of such a policy are very many. It is not out of patriotic desire to see India represented in the foreign field that the starting of a foreign branch is recommended. A systematic encouragement can be given by them to their customers "to get a footing" into the foreign markets. Trade information and credit intelligence of trading firms all over the world of a highly practical character can be gathered by the intelligence department of the foreign branches. It can link domestic with foreign customers and expand India's growing

[30] The British Overseas Bank is practically meant to operate as a common foreign department for some of the smaller banks of the L. Money Market. The British Trade Corporation was mainly intended to provide British foreign banking facilities in different areas so as to encourage British manufacturers and traders without at the same time competing with well-established institutions.

[31] In New York branches in the fullest sense of the word are not allowed. Agencies can however be established and for this a foreign corporation has to pay a licensing fee of $250 annually to the Superintendent of the State Banking Department. It should also satisfy him as regards its financial stability and its powers under its foreign charter to open an agency. It must make certain returns in accordance with the provision of Section 147 of the Banking Law of New York.

trade and seek an outlet for marketing her manufactures. They can take up the financing of foreign drafts for exporters at all times. It is true that the Exchange Banks are now doing this business, but there should be a systematic policy on the part of the Indian jt.-st. banks [32] to help the domestic trader to get into living touch with the foreign market and it is undoubtedly true that "trade follows the bank as much as the flag."

The parent bank can profit by transacting foreign exchange business with the help of their foreign establishments. There is no reason why the Indian jt.-st. banks should not undertake exchange business and finance the domestic trader's foreign drafts. The jealousy of the Exchange Banks would stand in the way but there is no reason why they should resent fair competition with such strong institutions ; it would force them to conduct their business on safe and sound lines. Competition among several banks to do this business means that importers and the general public would be able to purchase their drafts at a lower price than formerly.

The clientele of the bank reap ample advantages in transacting the whole of their banking business with one bank. They make international payments or obtain ample credit facilities in the United Kingdom and in the foreign countries. The foreign branch may serve as a good auxiliary through the medium of advertisement and personal invitation to attract deposits. It may obtain much prominence for the parent bank among the foreign banks by whom its foreign exchange is purchased and among the other banks of the world with whom accounts are kept and by whom drafts against its letters of credit are negotiated.

The foreign branch of a bank practically transforms the parent bank into an international banking institution. It thereby vastly expands its usefulness and places it in close touch with long-established industrial and monetary centres of the world. As our national savings and income expand the foreign branches of the bigger joint-stock banks may enable them to place their funds at remunerative rates of interest whenever an opportunity affords itself in the money markets

[32] They should make it a systematic policy on their part to insure stability of foreign exchange transactions conducted by them.

of the world, by the purchase of foreign bills of exchange as an investment, or permit them to borrow funds at favourable rates in the money markets of the world by issuing finance bills. The foreign branch may enable the parent bank to cultivate friendship and comradeship with the master financiers of London and New York whose opinion as regards Indian financial matters will be of much value to the Indian Banks.

These are some of the advantages of a foreign branch if it is soundly and conservatively managed. America which was so long dead against the branch bank policy has deliberately undertaken the opening of foreign branches to help their customers. The National City Bank of New York has 45 branches in its foreign system and is contemplating expansion of its business in the new fields. They have a number of foreign trade experts whose sole business is to furnish the domestic exporters with the information of the state of foreign customers, the nature, extent, and volume of their business and lastly the bank finances the foreign drafts of the American exporter. He opens a current account with the bank and turns over all its foreign drafts to this bank for collection by its foreign branches and this sum is credited to the customer's account. He makes an agreement that the bank should accept all the clean drafts drawn upon the bank itself to a certain limit which is determined by the volume of his export trade and thus the domestic trader finances himself for the short period in the most economical manner and the policy has been styled "the refinancing by acceptance" and it is by this means the bank encourages the foreign trade business.

It is high time that some of our banks should learn such methods and expand their field of operations from domestic banking to wider fields of international finance by opening foreign branches or starting separate banking companies in the foreign countries working solely under their control.[33] They should study local conditions in foreign

33 This can be resorted to in case the taxation levied by the foreign country is very heavy and is likely to wipe out a y profit that may be forthcoming. This is exactly what the Westminster Bank did when the Spanish Government began to impose a tax on the entire capital of the bank Of late some people have been recommending the very same measures in the country but they do not realise that it can be easily evaded by registering separate companies.

countries carefully. They should secure continual advice and co-operation of men acquainted with important business firms. They should take precautions against losses arising out of currency fluctuations. They have to adapt themselves to surrounding conditions, including laws, business customs, and observe the precedents of local banks. The foreign branch must first start its business by dealing successfully with foreign exchange operations. The foreign banks would have to purchase and make advances against commercial bills drawn on importers in the country where they transact business. Under all circumstances they should avoid over-extended foreign commitments.

The foreign branches must enable their home office in India to develop acceptance business. It is only after a successful transaction of this business that loan and discount business should be taken up. The attracting of current local accounts can then be systematically pursued. Their advances must be of a short-term nature. Foreign commerce can benefit the bigger Indian joint-stock banks by furnishing for their funds a legitimate and genuine field for use and thereby lessen the temptation to enter the arena of speculative investment. But service to the domestic clients should be the sole object and the profit-making motive must be subordinated. Domestic traders can also be provided with convenient facilities for securing finance abroad.

The misguided notion that foreign branches eat up the parent bank's capital and draw funds away from domestic use is not at all correct. A foreign branch is indeed a costly affair and it certainly takes a long time to establish its reputation for honesty. But it may then attract more deposits than what it actually lends there. Originally the Indian Exchange Banks could not attract Indian deposits. They relied to a great extent on their own capital and deposits attracted in London. But now they are able to tap the pockets of the Indian people also. The same is the case with the Chartered Banks of Canada. They have branches or agencies in the United Kingdom, the United States of America, France, Spain, Italy, the West Indies, Cuba, Mexico, Central and South Africa and in the Orient also. They give every facility to the Canadian exporter to secure foreign markets. They enter the field and pave the way for trade expansion. Exporters

are sent to every country to study and report on trade possibilities. These Canadian banks do not consider these branches as a financial burden. They have actually loaned outside of Canada sums up to $183,000,000 (call loans in New York excepted) while outside deposits have amounted to $318,200,000.[34] The same has been the experience of the British joint-stock banks when they opened foreign branches in France.

It must however be emphasised that all the Indian banks need not go about in pursuit of foreign exchange business but those that do enter into competition with the immigrant exchange banks would do well to remember that a foreign branch is an indispensable accoutrement for an efficient and successful transaction of this business and it is false economy to rely on the services of foreign agents. But those banks that aspire to "do their bit" in the expanding of India's foreign trade and industries cannot really acheive anything unless and until they are directly represented in the foreign countries. Foreign banks generally care more for the industries of their own country and usually do not perform their services with secrecy and impartiality. American Industry and trade suffered largely by frequent disclosures through the medium of foreign banks. Hence certain American banks were encouraged to open foreign branches for collecting export bills, honouring and issuing letters of credit and supplying current credit information for the benefit of American industry gathered from dependable sources.

But those banks that wish to confine themselves to the internal operations of loaning, overdrafts, discounting and aspire to mobilise our monetary resources should not open a foreign branch but keep clear of "foreign entanglements" as it will be a costly luxury to them.[35] The unusual responsibilities of local deposit and commercial banking

[34] *Vide* H. Fisk—"The Dominion of Canada" published by the Bankers Trust Co., New York, 1920, p. 60.

The troubled conditions in Europe and its depreciated currency gave scope to these branches to secure good deposits. Balances have in most cases been transferred from uncertain currency into more certain currency and so the deposits of the branches of the English joint-stock banks grew at the expense of local banks.

[35] The Alliance Bank of Simla lost 32 lakhs on account of the mismanagement of the London Agents, Messrs. Boultan Bros. & Co. in 1920. It was forced to open its own branch later on.

and legitimate satisfaction of its clients in the matter of banking accommodation must be thoroughly grasped by the foreign branches. The Midland Bank which is one of the Big Five in London systematically pursues this policy of keeping aloof from foreign deposit banking or even affiliations abroad.[36] The rest of the "Big Five" have girded their loins for increased foreign activity. In the words of Sir John Fergusson of Lloyd's Bank the policy of big banks is "to serve the world" and secure a compact and co-ordinated All-British Imperial and World Banking system" as the *London Times* puts it. English Banks have their directors nominated to several affiliated foreign banks and they have acquired interests not only on the European Continent, but in South Africa, America, Australasia and Asia.

Bills of Exchange.

In the chapter on the Indian joint-stock banks the necessity of employing uniform standard credit instruments preferably of the bilingual type has been pointed out. There has been no bankers' association enforcing or arranging and promoting the use of stereotyped forms of contracts, agreements, vouchers, accounts and other documents employed in banking business. It is indeed high time that this grave omission is rectified and the inland bills of exchange must become very popular as credit instruments.

Financing of Inland Trade.

Sufficient attention was not drawn to the internal bills of exchange or inland trade bills till the year 1920 and the Indian banks never cared to finance inland trade largely by means of discounting trade bills. It is indeed true that *hundies* were used to a limited extent in this direction. But, broadly speaking, the system of cash credit was adopted in preference to trade bills. The advance is made on demand

36 See the Chairman's address to the shareholders at the Annual Meeting, 1921, quoted from the Bankers' Magazine, London. But the other banks belonging to the Big Five have opened banks which they control in France, Spain and Belgium. But they realise that the limit of extension in the foreign fields has been reached.

promissory notes signed by two or more persons unconnected with each other in general partnership with collateral security when necessary. The bulk of our mercantile business is transacted on this cash credit basis or "running overdraft" basis as bankers put it. An export merchant who wishes to secure banking accommodation to help him in the export of raw material would approach the banker and secure 20 or 25 lakhs as the maximum for the overdraft for a specified period. The actual accommodation however depends on the varying needs of his business. This affords him cheaper finance than any other methods. He usually takes notes or rupees from the bank and purchases the product from the cultivator direct or through an intermediary and no bill is drawn on him or his intermediary by the cultivator. He sends the material out of the country and draws on the foreigner. This export bill is bought by the exchange bank and the proceeds would enable the merchant to pay the loan to the domestic bank.

What happened in 1920 and after.

The analogy of the Federal Reserve Board appealed strongly to the Babington Smith Committee which recommended the issuing of seasonal currency against export bills.[37] When the Paper Currency Act of 1920 was passed the difficulties of basing the seasonal expansion of currency up to five crores of rupees on export bills were realised and in their place the internal bills of exchange or *hundies* were recommended as suitable cover.[38] Detailed regulations were issued on 16th February, 1922, to this effect. The rate of interest at which this seasonal currency was made available to the Imperial Bank was fixed at 8%. The experience gained in this matter during the two busy seasons of 1922-23 and 1923-24 pointing out the necessity of raising this limit from five to twelve crores of rupees. The loans were also made available to the Imperial Bank as soon as the bank rate rose to six per cent. and the whole amount was made available at a predetermined schedule of bank

[37] See Mr. M. M. S. Gubbay's Oral Evidence before the Hilton-Young Commission, Vol. V, p. 110.

[38] For a succinct summary of provisions for seasonal expansion of currency, see the Memorandum of Mr. A. C. McWatters submitted to the Hilton-Young Commission, Vol. II, Appendix 3, pp. 19 and 20.

rates. But during the busy season of 1923-24 in addition to this expansion, notes had to be issued by adding the British Treasury Bills to the extent of 12 crores in the Paper Currency Reserve. In September 1924, it was announced that Treasury Bills would be used as the basis for expansion of the P. C. R. and a change was also made in the issuing of loans to the Imperial Bank. Four crores were made available at six per cent. and the remainder at seven per cent. The Government also undertook to reimburse the Imperial Bank for the amount of loss sustained by it in " creating bills " to the necessary limit.

It is indeed disappointing to find that although self-liquidating bills of exchange were recognised as the basis for seasonal currency and due provision was made for it still no attempt was made to popularise these bills of exchange. The Imperial Bank had really to "manufacture " bills out of cash credits granted to the merchants. As a heavy stamp duty had to be paid on these bills the bank had to consent to bear this duty and although the Government came to the rescue of the bank in this connection neither the Government nor the Imperial Bank undertook any measure to increase the volume of internal trade bills of exchange. The paucity of bills and the absence of an active discount market were realised by the advocates of the Central Bank of Issue but they preferred to run the risk of prematurity in starting this Central Bank. Although there is no other method so successful as the starting of a Central Bank for the improvement of the discount market, still other attempts must be made to popularise the drawing of trade bills.

Recommendations of the Bengal Chamber of Commerce.

The Bengal Chamber of Commerce in its memorandum drawn in September 1924, drew attention to the necessity of increasing the bills of exchange and suggested that the stamp duty should be reduced and the Government should willingly accept bills on stores purchased locally so that these would become popular instruments available for discount in the money market. Some of the more successful and large-scale manufacturing firms like the Tata Sons and Co., already adopted by this time the practice of drawing on the wholesale merchants and these were freely discounted by the banks in the Calcutta

Money Market. The Railway Company should similarly accept bills drawn on them by tenderers of goods and as there is abnormal delay at present in the payment of money the seller of the goods can easily realise the money by selling these bills in the market. The present loss of interest would be obviated. However the financing of crop movements from the up-country to the port centres or the centres of trade was not done by the internal bills of exchange and unless this is done freely bills would not increase and an open discount market cannot be created in this country as in the case of the economically developed Western countries. Lack of knowledge of bank acceptance and adherence to old and time-honoured methods must have been the sole causes responsible for our backwardness in the use of bills of exchange.

Advantages of multiplying the Trade Bills.

The Central Bank's business is admittedly to finance the commercial banks by rediscounting their bills, or if open market operations are allowed, the buying of such bills of first class character is its legitimate function. To facilitate the free and successful functioning of the Central Bank these bills have to be created and a discount market dealing with these bills has to be developed. Secondly the ordinary banks stand to gain much by discounting these self-liquidating genuine trade-bills. One great difficulty in the matter of branch extension by the joint-stock banks is the non-availability of such liquid instruments as these short-term trade bills. If enough scope exists for discounting such bills the bank would not feel it difficult to embark on such a policy of branch extension in the interior. The general public would stand to gain by stabilised money rates. Thirdly it is admitted by all that the system of providing currency on the security of bills of exchange tends to make it automatic and due expansion and contraction takes place as fresh currency is issued against bills and as these mature there is automatic contraction of the same. It is in the interests of sound currency that these internal bills of exchange should be developed. Fourthly, it must be remembered that the Imperial Bank is becoming more and more censorious in the matter of the *hundies*. It is of opinion that *hundies* are becoming "very risky documents."

One of the Governors of the Imperial Bank[39] is, of opinion, that "*hundi* brokers generally are not of a reliable character and they have the knack of disappearing in a monetary crisis. Any bank which wishes to discount largely these *hundies* should take security from these brokers which should be confiscated if any loss arises out of these transactions. Endorsees of these *hundies* must also be of a solvent character. All these precautions are essential to check kite-flying by men of doubtful standing in the money market. Finally, the creation of an open discount market has to be faced and when self-liquidating bills can be converted into gold the holding of such bills by foreign banks might be brought about. Continental banks are freely purchasing bank bills in the London Money Market and they do not buy even British Treasury Bills for they are precluded from buying bills unless they have two names.[40] Similarly foreign banks might care to hold our bank acceptance if we succeed in maintaining a free gold market and levy no practical hindrances in the matter of the export of gold from the country. Lastly the habit of drawing bills has to be encouraged and if the indigenous bankers are assured of rediscounting facilities at the hands of the joint-stock banks and the Imperial Bank they would perform the original discounting of these bills and the cultivator can secure cash from the indigenous banker. These can act as the discount houses in this country. [41] The indigenous banker would collect the proceeds of the trade bill from the drawee merchant who has already accepted it. He would have to be rewarded for this service. If his monetary compensation is higher than the cost of securing a cash credit [42] from a banker and moving rupees or notes into the interior this method of financing internal trade by means of drawing bills would never become an established fact.

39 See the late Sir D. E. Wacha, Written Evidence before the Hilton-Young Commission, Vol. II, p. 398.

40 See S. E. Thomas " Principles and Arithmetic of Foreign Exchange, " 3rd Edition, pp. 96-99.

41 Another original advantage forthcoming out of this practice would be the cheapening of the commission charges in matter of collecting bills in a place where the collecting banker has no branch of his own. The present practice of charging double commission charges would be discontinued and might tend to increase the use of bills.

42 The cash credit practice is however liked by the banker as he can immediately withdraw his credit if the financial position of the borrower becomes weakened. It is also advantageous to the customer since he pays interest on the actual borrowing of his.

Other Suggestions.

Now that my suggestion for a standardised inland bill of exchange drawn up in vernacular is accepted [43] it remains for the Local Governments to consider the reduction of the heavy stamp duty which has been suggested by the Hilton-Young[44] Commission and approved by the Government of India. As it is a matter for the Provincial Governments to decide it would take certain time to accomplish this needed change. To defeat the intentions of the law bills are drawn as Darsani or sight bills for these need not have to pay such heavy stamp duty as the usance bill. There is always the implied understanding that the bill would be renewed. As the present tax [45] which bills other than demand bills would have to pay, ranges from 3 annas to 27 rupees up to Rs. 30,000 and subject to Rs. 5 for every additional Rs. 10,000 or part thereof in excess of Rs. 30,000 is nearly two times heavier than the tax prevailing in the United Kingdom [46] there is every reason for prompt deduction of this "nuisance tax "—if the resources of the local Governments do not permit a complete abolition of the same. The Mysore Government have done well in abolishing the stamp duty on cheques as well as bills of exchange.[47]

A change in the methods of agricultural financing will enable the bank to lend more on goods stationed in licensed warehouses or the borrower's godowns and this would lead to a free drawing of bills of exchange against goods and commodities on a greater scale than at present. The creation of licensed warehouses in the interior would enable the drawing of documentary bills which can be freely discounted.

43 See Rau, " Present Day Banking in India." 2nd Edn., p. 110. Bilingual printed forms for bills of exchange will greatly facilitate the use of the bills of exchange

44 See para. 116 of the Hilton-Young Commission's Report.

45 See Article 13 of the first schedule of the Indian Stamps Act, 1899 and the Amendment of 1910.

46 See the Todhunter Committee Report, p. 223.

47 Since these recommendations were made the I. C. B. Enquiry Committee suggested that this duty should be abolished during the course of five years by the different provincial Governments. It also suggested that the stamp duty on all bills of exchange of less than one year's usance should be reduced to As. 2 per three thousand rupees.

A change in the law is also needed. The existing law with reference to the practice of the bills of exchange or hundies needs distinct change in favour of the banks. A negotiable instrument if originally drawn as a bearer instrument must always continue to be so and should not lose its bearer character by any restriction or reservation by reason of subsequent specific endorsements.[48]

The lack of standardisation in the matter of the indigenous bill of exchange or the *hundi,* the use of vernacular and the varied local usages attending on the *hundies* have placed intolerable difficulties for the legislator and these *hnndies* are no longer governed by the Negotiable Instruments Act. A standardised *hundi* is essential but our efforts should be concentrated in the development of trade acceptances and the education of the businessmen in the use of these bills is absolutely essential. This would eliminate the chief danger behind the hundi, *i. e.*, most of the hundies are of the finance bill character. A trade bill with attendant documents which bespeak of its origin would rid all these evils.

Permission should also be granted to put in not only the embossed stamp in the bill or *hundi* paper but an adhesive stamp can as well be affixed. This would bring in difficulties in the matter of allocating the stamp revenue between the Provincial Government and the Central Government.[49] Some remedy should however be devised to overcome the administrative difficulty and allow the people to put an adhesive stamp on the bills. In America during the war time there was a stamp duty levied on the cheques and bills but they were understood to create a good lot of "nuisance" so that these "nuisance taxes" were the first to be abolished as soon as peace was restored.[50]

Much capital has been made out of the illiteracy of the people. It is indeed true that a large number of our people cannot read and write. In Egypt the illiterate people kept deposit accounts with banks though they had no idea of how to write their own names.[51] It is confidence which is essential in this matter. Lacking this

[48] Since these lines have been written this suggested change has been carried out.

[49] See the Report of the Indian Chamber of Commerce.

[50] See the Evidence of the American Witnesses before the Hilton-Young Commission, Vol. V, p. 314.

[51] See F. T. Rowlatt's Oral Evidence before the Babington Smith Committee.

there would be no free mobility of capital or any other use cannot be made of banking instruments if our joint-stock banks fail to conduct conservative banking business.

Even if the legend on the bill is drawn up in vernacular in a standardised form it would not work miracles in the matter of making these instruments popular ones. A legitimate campaign for the free use of these bills must be undertaken in this country. Merchants should be granted preferential terms by the sellers of commodities and the wholesale merchants should grant preferential rates to retailers who are willing to accept bills in lieu of obtaining and accepting credit on open accounts. Commercial banks should be granting preferential rates to merchants who finance themselves by discounting bills than to those who borrow on overdraft or by one-name promissory notes. The Central Bank itself would have to grant preferential discount and rediscount rates on trade acceptances.[52] In order to promote the custom of drawing bills some Central Banks are empowered in their charters to charge higher rates on advances than on discounts. The Reichsbank had to rehabilitate the bill of exchange as an instrument of payment in commercial transactions and the private discount market was reconstituted and the practice of bank acceptance was resumed once more.[53] By August 1926 bank acceptances rose to 314 mill. Reichsmark. But it has not yet assumed the pre-war size and extent. The charters of the Central Banks of Austria, Hungary, Czechoslovakia, and the National Bank of Bulgaria prescribe that if the banks' loans exceed the total of the bills held, the rate charged for advances is to be raised to one and a half times the discount rate.[54] No such provision was enrolled in the various bills of the Reserve Bank, 1927-28. Even the new Reserve Bank Act of 1934 does not make allowance for this feature. The Imperial Bank and the commercial banks would stand to gain if they freely discount these genuine trade bills for these can be rediscounted at the hands of the Reserve

[52] Similar measures were advocated by the Kemmerer Commission. See Report on the Reversion to the Gold Standard in South Africa, para. 49 (2).

[53] See Dr. H. Schaat, The Stabilisation of the Mark, p. 196.

[54] See C. H. Kisch and W. A. Elkin, Central Banks, pp. 133 and 134.

Bank.[55] There should be a vigorous campaign conducted by all parties—the Government, the Imperial Bank, the joint-stock banks, the shroffs and the co-operative purchase and sale societies—to create these bills. By moral influence as well as pecuniary inducement efforts must be made to increase the bills of exchange. It would create a healthy and desirable development in Indian monetary progress.

Dangers to be guarded against.

There is always the danger of a Micawber drawing bills for his household expenses on the fond hope that something would turn up to save him in the long run. It is the duty of the indigenous banker to see that such abuse of bills is not made. Such accommodation bills should be eschewed altogether. Knowing the nature of the parties and their business it would not be difficult for the indigenous banker to know the *bona-fides* of the transaction. " Cross-firing " a vicious practice freely indulged in some of the western countries should also be checked. Anticipatory bills are freely drawn and discounted by banks in America but there is a very grave danger with regard to these types of bills. As our agriculture is subject to pests, diseases of crops, and storms it might so happen that it would be as foolish as counting chickens before they are actually hatched The practice of renewal of maturing bills should be frowned upon and the indigenous banker or the original discounting body should be aware of the fact that too frequent or continuous and indiscriminate renewals mean a departure from the strict principles of banking and might involve them in pecuniary loss in the long run. The period for which bills would run might undoubtedly be longer, for agricultural trading in the interior, deprived of proper means in the matter of conveyance

55 As the Reserve Bank is a non-competing bank the fear that trade secrets would be given away need not be entertained. The lowering of the discount rates as a result of the co-ordination of the different constituents of the money market would facilitate the use of the bills. The Reserve Bank should also discount trade bills even without a bank endorsement though perhaps it might charge a higher rate in this case than in the case of scheduled banks.

56 See the London Banker's Magazine, Dec. 1927—" A scheme for the Numbering of Bank Offices, by *E. R. Bardsley*.

facilities, requires longer time than any other industry. With such suitable safeguards as are outlined here the discounting of inland trade bills should be freely done and so long as bills up to a certain limit are discounted by the banks there is no reason to suppose that the solvency of the banks would be threatened.

Mechanisation.

In most of the advanced countries the use of adding machines and other mechanical devices for performing the routine stereotyped work has become an accepted feature of banking business. In order to facilitate the work of the adding machines the big banks number their branches and the suggestion has been mooted that banks should be numbered so that adding machines can now be freely used in dealing with the cheques.[57] Such mechanical devices would not lead to an obsolescence of brains of the bank clerks but would tend to free them from the routine duty so as to be in a position to release their mental faculties for better use. There is no reason why Indian Banks should lag behind the other banks in this respect. The adding machine is used to facilitate the clearing of cheques in the local Clearing House. Some photographic apparatus can be used for taking number of copies of documents, which are to be filed in the banking offices. Ledger entries in some of the English Banks such as Messrs. Coutts & Co. and Messrs. H. J. Schroeder & Co. are made by machinery. In America the richer commercial banks get their ledgers written up by the Burrows Adding Machine. There are different devices for copying letters and documents, for sorting, arranging and filing vouchers, for stamping work of all kinds, machines for subtracting and multiplying and preparing statements and for sorting and counting coins.

Although the advantages of using machinery for routine work is understood the real reason why no move in this direction has been made is that clerical labour in this country is very cheap and the cost of the imported machines is undoubtedly very high. But in the interests of quick and accurate work the use of these mechanical

57 See also the Banker's Magazine, July-December, 1926, p. 85.

appliances should be encouraged. The Indian Railways use accounting and calculating machinery in the compilation of statistics and they are second to none in their equipment. As an increased volume of account work can be turned out by machines without excessive additional cost, they must be used by our joint-stock banks on a larger scale than at present.

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CHAPTER XX

Banking Legislation

The Rationale of banking legislation—Foreign banking legislation—Special circumstances of India—Suggestions.

The Rationale.

Banking is of high antiquity. Our ancestors were undoubtedly familiar with banking credit. At least history credits them with that knowledge. Archaeologists have discovered clay *tablets* of credit that were in use in the Kingdom of Assyria.[1] Students of Manu, the famous Indian law-giver, are familiar with the well-known laws regulating the use of credit. The Athenian money-changers did business somewhat closely akin to modern banking business. Xenophon anticipated the idea of a bank but he was too far ahead of his time. In the *Argentarii* of Rome can be seen the nearest possible approximation of a modern banker. The barbarian invasions of Rome and the ensuing unsettled conditions of Europe during the Dark Ages must have prevented the early development of banking business.[2] During the Middle Ages the money-changers of Italy revived their business and the Jews, thanks to the persecutions of all continental countries, perfected the beautiful bill of exchange. The successful lead of the Italian merchants and their religious zeal to collect the *papal dues* while acting as the emissaries of the Pope in the continental countries led to a very extensive use of the bill of exchange. To Italy belongs the credit of having founded the first banks, *viz.*, the Bank of

[1] See Collins' Banking Law. Collins also says that one Egibi & Co. acted as the national bank for the Babylonian monarchs. These baked clay tablets are preserved in the British Museum.

[2] According to the Roman Law each family had to maintain a ledger in which the head of the family had to keep a record of borrowed money or money lent, all profits and losses or any disbursements of any kind. These ledgers were the only legal evidence in a court of justice. It is from this custom of book-keeping that the modern credit system has developed.

Venice (1167) and the Bank of Genoa (1345). The Italian money-changer, the Jewish money-lender and the Lombard-street financier are the important connecting links in the banking chain. With the advance of centralisation in commerce and national life the necessity for public banks arose. The development of manufactures and rapid growth of international trade led to large-scale banking and to-day banking business is regarded as an honoured profession. It has received such a wide and varied form that it is hard to believe that our ancestors were not familiar even with the rudiments of banking credit.

If banking business is of such hoary antiquity and if state regulation of bankers and banking credit was well known to our ancients as evidenced by the Athenian regulations, the Code of Manu, and the Justinian laws,[3] the modern state ought to feel ashamed at the perfunctory manner in which it attempts to control the modern banking business in the interests and well-being of the nation.

Besides this historical justification there is another cardinal reason why the state should control banking business. The modern banks can make or mar the future of a nation. With the entire credit mechanism of the country controlled by it, with the whole floating capital of the nation deposited in its hands, with the nations' material future entrusted to it and with " the fate of the nation lying on its las " the modern banking system is indeed a vitalising force, which, if exerted in the right and proper channels, is fraught with immense possibilities. With a judicious selection of their customers and with timely loans to them they can build up the manufactures of a country and direct capital and labour to the most productive channels. By creating thriving industries they can add to the national wealth of the people and bring contentment to the wage-earning labourers. They can accomplish all this and more.[4]

But their power to do harm in case of misdirecting capital, encouraging speculation, and wrong investment is no less considerable. What the state aims at by wisely directed banking legislation is to maximise the advantages of sound banking and help the banks to

3 When the learned writer MacLeod said that " Banking in the modern sense of the term did not exist before 1816 " he probably only meant this thing.

4 For an exhaustive treatment of this subject see my " Elementary Banking," section entitled " Economic Services of Banks."

better perform their task. Modern banking is a quasi-public service to be watched and properly regulated. The anxiety of the state is to see that banking accommodation is being extended to all the deserving persons on equal terms. Banks are public utilities intended to distribute their resources mainly with an eye for the public benefit.

The failure of a bank creates a vicious circle and ruins several people. Though the state recognises the impossibility of legislating to prevent failures yet attempts should be made to prohibit banks to do business of an unsafe character or alien to legitimate banking business.

The state while passing laws of a restrictive nature forbidding the banks to do as they like is not altogether unmindful of the interests of the bank. It recognises the social services of the banks and gives them special facilities. The special laws about the negotiable instruments and other concessions shown to them as the general lien of the banks, the law of estoppel, and the Banker's Book Evidence Act are an evidence of this grateful recognition. While treating them very leniently the state does not forget to restrain effectively their power to do harm to the public by their own indiscretion. General laws are passed so as to attain uniformity and prevent favouritism.

Banking legislation extends from the Central Bank right up to the ordinary joint-stock banks. The Central Bank is always made to work under special provisions incorporated in a separate charter. The ordinary joint-stock banks are incorporated under another law common to all of them. Private banks escape vexatious Government control in almost all countries. Their importance is however dwindling day by day. So long as they are under able financial guidance they earn the gratitude of the country. But the continuity of such able financial guidance is not assured at all in all cases. Many ignominious failures have occurred in the past. Hence private banking is diminishing in importance. In England [5] and America public opinion is decidedly against them. They are virtually forced to amalgamate themselves with other concerns by virile competition

[5] In England the position of the private banker used to be happy at one time. Walter Bagehot says, " there has probably very rarely been so happy a position as that of the London private banker and never perhaps a happier." This remark might have been true in his own time but to-day the demand for greater publicity and greater security for associated capital is working against the private banks.

prevailing in the money market. Here as elsewhere the case of India forms a notable exception. In India the private bankers (indigenous bankers as they are styled) are going on as usual. But the growth of the Co-operative Credit Societies is leading to the narrowing down of their *clientele*. The education of the masses, the general stability of the joint-stock banks, a wide diffusion of sound banking facilities and the general apathy shown by the indigenous, *i.e.* private, bankers towards industrial development, will certainly tell their own tale in the long run. These indigenous bankers, unless they become more progressive and adopt the best features of joint-stock banking and adapt themselves to the changing needs of the society are bound to disappear in our country also. But they are still a powerful element in our banking system to-day.

The case of joint-stock banks is different. They are under able financial guidance and influential directors can mould the institutions into such a shape as to bring about the greatest good of the greatest number of people in a given society. The necessity to earn profits must force the banks towards progress tempered with caution. [6] Hence joint-stock banks are on the increase everywhere. As the banking blue-book indicates they are increasing in numbers in our country also.

The main reasons why the state is so solicitous to procure sound banking conditions have been set forth already. But something more must needs be stated to explain why joint-stock companies conducting banking business are differentiated from other joint-stock companies and treated separately. One law does not suit both of them because the banks are lending. A paucity of capital will not enable the banking institution to execute its tremendous task of responsibility and trust efficiently, hence the legal regulations against inadequate

[6] Lord Overstone writing in 1892 says, " joint-stock banks are deficient in everything requisite for the conduct of the banking business except extended responsibilities." Bagehot commenting on this statement says that " the bankers of Lord Overstone's time lent much to private individuals from whom no security could be obtained. The banker acted on the judgment of discretion, the credit and solvency of those to whom he lent." But now the banks have ample material to judge the standing of the borrower. Credit information of a high order can be obtained easily. It is now possible to scrutinise the balance sheet of the borrower, and good securities can be taken as collateral for covering loans.

banking capitalisation. In the case of new banks, there is always an impairment of capital for the first few years as expenses run in excess of interest collections and unless there is a large amount of capital actually paid-up at the start, it is difficult to meet with success.

Legislators wish to regulate not only the amount of capital required for the starting of a joint-stock banking company but they also insist that a due proportion, say one-half or one-third, of the subscribed capital should be paid immediately at the start and the balance to be paid within six months at the utmost. Their aim is to prevent the banking company from being handicapped to any extent by virtue of its meagre capital. A large capital also renders unnecessary "touting" for business to get profits or canvassing for depositors by paying a high deposit rate.

Coming to the reserve the state aims to compel the banks accumulating a decent reserve in order to help the bank in its operations. The reserve is virtually the shareholder's property and can be locked up with impunity and the greater the reserves the greater is the confidence inspired in the minds of its customers as regards the utility of the banks to discharge their liabilities.

A large reserve acts as a buffer receiving all sudden and unexpected shocks such as a great depreciation of assets for which no provision has been made and bad losses greater than the amount of profit earned during the course of the year. The presence of a large reserve on such occasions saves the original capital from being washed away by these unforeseen happenings. It may be utilised for the equalising of dividends.

It is by loaning that a bank confers its greatest blessings on society and its business. The strength and safety of the bank depends on the character of the loans it grants. The bank has not only to select judiciously its customers but it must not commit the fatal error of lending too much of its loanable money to any individual firm or undertaking. The object of the legislator is to see that the bank distributes its risks over several concerns or individuals of the most unimpeachable honesty, financial rectitude and business capacity.

Another object why loans by banks to its officers and directors are restricted is to see that no greater line of credit is granted to them than they can obtain from any conservative banker. Even in the matter of discounting business the anxiety of the legislator is to curtail

the freedom of banks from accepting anything except first class paper or tying up their money in transactions of a spurious character.

Legislators wish to prohibit the bank from lending on the mortgage of real property as it would lead to a locking up of the short-term deposit money in long-term loaning. Hankey, a practical banker, says, "the commercial banker has to realise the enormous difference between a bill of exchange and a mortgage of real property." The difficulty of ascertaining the true ownership of those kinds of real property as houses and land and the legal restrictions that are attendant on the transactions of such property preclude them from the commercial bankers' choice. He has neither the time nor the ability to assess their value carefully and loan on them.

Legislators realise that a wise management of the loaning business conduces to the stability of the bank and enables it to pull on with a small cash reserve and does not lead to an unwise expansion of credit.

The cash reserve of the bank is not only the foundation of any credit that can be created by it but is an insurance fund against risks. It enables the bank to meet any unusual and extraordinary demands made on it by the depositors. The object of regulating the cash reserve, fixing its dimensions, and even prescribing its actual composition is to enable the bank to better perform its task and as the bank is always saddled with large numerous "demand" deposits to be paid there should be a guarantee that it can meet the depositors' call. The desire to earn profits is very natural and the tendency to reduce the cash reserve almost to the breaking point or "apprehension limit" as Bagehot puts it has to be curbed by laws.

It is true that a legal limit to the cash reserve tends to make it inelastic and any law prohibiting its free use in case of rare emergencies is meaningless. As Mr. Robertson says, "an iron ration which you must not touch even in the throes of starvation is something of a mockery." It generates a sense of false security. By keeping the prescribed limit of cash reserves the bank may think that it has done everything it has to do. But laws should be so framed as to furnish a free use of the cash reserve and the fact that it is kept and that it enables the bankers to meet some portion of their liabilities is a source of confidence. It limits the field of disaster that may be brought about by injudicious or adventuresome banking. Instead of overwhelming

and complete bankruptcy there is something which enables the banks to dole out to their creditors.

Successful banking is virtually dependent on a careful management of the cash reserve. While recognising that " the cash reserve is dead money and makes no contribution to the dividend whatsoever" as Prof. Foxwell puts it, the bank managers should possess a cool head, sound judgment and a resourceful mind. By constantly adjusting their discount rate they should bring about satisfactory conditions always. Very few banks realise that it is better to err on the side of caution and provide a large cash reserve thereby making a part of it idle rather than be adventurous with a smaller cash reserve. The banks should not rely on their ability and management "to muddle through somehow" as Lord Rosebery puts it. To avoid failure is far more important than to keep up high and precarious profits. Bagehot says, " adventure is the life of commerce but caution if not timidity is the essence of banking."

As regards investments, that is, the bank's holding of gilt-edged securities, the object of the legislation is to make the banks invest their funds in such a way as not only to yield profits but see that they are at the same time liquid. Only first class securities are to be held and these should possess absolute strength and safety and be easily marketable with the minimum trouble and risk of loss. As several of the ordinary industrial securities do not possess those coveted features the banks are prohibited by law to invest their funds in them.

Publicity.

In addition to those laws hampering the freedom of the banks almost in every kind of their business the state insists on banks publishing their transactions periodically. Although some of the banks may resort to the pernicious practice of window-dressing at the time of publishing their balance sheets yet much can be gained by publicity. The furnishing of a well-informing balance-sheet which actually unfolds the tale of progress and increase of business is by itself the most successful method of transacting business and attracting customers to the bank. The joint-stock banks of other countries have realised the manifold advantages of publicity and they are coming forward of their own accord to furnish all details of their business transactions.

This is the *raison d'etre* of all banking legislation and there is ample justification for the state regulation of banking business. The state knows full well that the banks cannot be made safe and well-managed automatically by means of its laws and regulations. It realises that no system of examinations can be a perfect one. It always grants considerable latitude in the matter of loans and knows clearly that to impose a dull uniformity without paying any due heed to the changing conditions of different localities, will be of no avail. Hence it is wise enough not to *descend* to details. It is fully conscious of the fact that honesty, integrity and capacity cannot be obtained through the process of legislation. It cannot and does not aim to legislate so as to secure people from their own lack of business qualities. Such is the psychology of the bank-controlling mind.

It is indeed difficult to explain the absence of any banking legislation in our country. It cannot be ·ttributed to any lack of knowledge in this particular sphere. Our semi-state banking institution which was recently appointed as the *sole agent of the Reserve Bank* is controlled by the state. Its position does not cause any great anxiety for the state in the fullness of its banking wisdom has retained certain control over it [7] as yet. It is only the position of the newly started and small joint-stock banks that is totally unsatisfactory. The wonder is why the state has not thought it wise on its part to fetter the hands of these joint-stock banks by well-drafted regulations.

Another instance which goes to prove that our state possesses a high conception of its duty towards banking institutions, occurred quite recently during the days of the banking crisis of 1913-1?. It volunteered to give pecuniary help to all the sound banks but the old Presidency Banks through whose medium and intervention the state wanted to help did not rise equal to the situation and this episode forms one of the worst spots in the dark pages of their history. They cast to the winds the expansion theory of banking which Central Banks generally pursue during the period of a crisis.

Again their policy of welcoming all foreign banks and extending an open door to them resulted in much good to our country.[8] These

[7] *Vide* the Chapter, "*The Imperial Bank of India.*"

[8] Spain resented the intrusion of foreign banks and passed the legislation against such intrusion with the result that the Spanish branches of the London, County, Westminster and Paris Foreign Bank, Ltd., had to be closed.

have not only popularised banking business in our country but are the standing monuments of a conservative policy for slow, sure and steady progress in banking business.

But the *non-possumus* attitude of our state towards the smaller and newly arisen joint-stock banks is hardly creditable to it. The existence of some kind of laws, good or mediocre, would have prevented several failures or at least would have mitigated the intensity and severity of our banking crisis.

Foreign Banking Legislation.

The cardinal reasons actuating the minds of the legislators while framing restrictive laws on the operations of the banking companies have been set forth in detail. It is not the Central Banks alone that are regulated but banks of deposit also are subject to state regulation. Note-issue is generally concentrated in the hands of the Central Banks and it is everywhere the subject of detailed regulations. The banks of deposit manufacture cheque-currency which constitutes the important medium of payment in advanced countries and 95% of the business transactions of modern societies are conducted through the principal means of "the cheque." It is this reason that must have forced the legislators to turn their attention towards the banks of deposit. This service must be rendered economically, efficiently and honestly by the deposit banks and hence their regulation While all countries have deemed it wise to control their note-issuing banks if any and their national banks, they differ in their treatment of the deposit banks. The case of the U. S. A. is quite unique.

America presents a splendid example of decentralised banking where many individual banks exist. The recently created F. R. Banking system is undoubtedly the recognised head but banking legislation is of too minute a character and the state takes much pains to avoid banking failures. In addition to Federal and State regulations the banks mutually agree on a common course of action and control themselves by the decisions arrived at in discussions of the Clearing Houses or at meetings of the Bankers' Association. Thus state direction is aided by mutual control and efforts are always made to help sound banks in times of emergency.

Coming to the details of banking legislation in the U. S. A. one finds the state laws to be so varying in nature and different that no adequate idea can be gained of them in such a concise chapter as this.[9] The laws for regulating the National banking companies are more uniform, rational and convincing.[10] Firstly, the capital of the bank is graded and regulated according to the inhabitants of the place. For 50,000 inhabitants a minimum capital of the banking company is fixed at dollars 200,000. Nextly, the National Bank Act requires 1/10 of the net profits to be set aside each year till a *reserve fund* is accumulated to 1/3 of the capital of the bank. As security for the depositors the National Bank Act insists on the double liability of the shareholders.[10a] As for note-issue (which will gradually cease in course of time) any national bank was permitted to invest the whole of its capital in Federal Government bonds and notes up to par value are entrusted to the bank by the Controller of Currency. Any National Bank issuing these notes must maintain a 5% redemption fund of the face value of the circulating notes in the hands of the Controlle. The Act prohibits the banks to lend on real estate. No loan can be granted to a single individual above 30% of the capital of the bank. An excess of the amount is permitted in case the bank lends on bona-fide bills of exchange and commercial paper owned by the customer. The National Bank Act requires 25% of all deposit liabilities to be kept as cash reserve.[11] In case it falls below the legal minimum discount business has to be stopped. Besides these rules National

[9] The State Banks and Trust Companies are given a wider scope of activity and are subject to close supervision of the State Superintendent of Banks. National Banks are now subject to federal legislation and are controlled by the Controller of Currency.

[10] For Government regulation of banking prior to 1860, see H.P. Will's American Banking, Chs. XIII and XIV. A good idea of the legislation affecting the State Banks and National Banks can be obtained from the Proceedings of the American Academy of Political and Social Science, Vol I (1911), pp. 286 to 290.

[10a] This feature has been abolished quite recently by the legislation of 1933-34.

[11] The various National Banks in the different American cities are divided into three classes : (*a*) National Banks in the C. R. Cities (Chicago, St. Louis and New York) have to maintain 25% cash reserve in lawful money. (*b*) Reserve City Banks (about 50 National Banks situated in towns whose population was not less than 50,000 inhabitants) must keep 25% but half of it might be deposited with National Banks in Central Reserve Cities. (*c*) Nationall Banks of the third class have to keep 15% of cash reserve and of this 3/5 can be deposited with the National Banks of the Reserve Cities. This rigid reserve requirement of National Banking Act of 1863 have been modified to a great extent by the F. R. Banking Act of 1913.

Banks are subject to periodical examination by the bank examiners specially appointed by the Comptroller of Currency. The National Bank Act requires the submission of five reports of their banking operations during the course of a single year. The Comptroller of Currency is invested with general supervising power over the banks and the charter of incorporation of each bank is to be renewed once in 20 years. The Indian readers will no doubt be staggered at the vast output of this banking legislation.[12] At present as a result of the recent banking crisis of 1931-33 the Government is running a large number of Commercial Banks along with private banks.[13]

In England, the home of the laissez-faire theory, similar supervision was never devised nor would it have been tolerated by the banks. The Bank Charter Act of 1844 recently revised in 1928 still governs the working of the Bank of England and its note-issue. The other banks are incorporated under the various Company Laws and beyond this there is no special legislation as regards banking business in England. English banking mainly evolved on the principle of every man for

The proportion was fixed at 18% instead of 25% in C. R. cities; and 15 instead of 25% in reserve cities and 12 instead of 15% elsewhere. Only 1/3 of the reserve was to be in cash and the remainder could be deposited with the F. R Bank. This Act was amended in 1917. The whole reserve was to be on deposit with the F. R. Bank, the cash was left to the unfettered discretion of the bank management. Proportions of C. R. were reduced to 13, 10 and 7%. Only 3% is required against time deposits while previously 5% reserve had to be kept. This peculiar law about the reserve helped the process of financial domination of Wall Street over the rest of the country. The National Banks are permitted by law to keep their reserve outside and the New York bankers absorbed the deposits to a great extent and utilised them in financing the dabblers of the stock exchange. But the F. R Act brought about the needed financial decentralisation. See R. G. Rodkey, "Our Legal Reserves."

[1] The recently passed Glass-Steagall Act of 1933 tries to increase the powers of the F.R. System and permits only non-members to enjoy the deposit insurance scheme till 1936. Then they have to join the F.R System or renounce the deposit guarantee. Attempts are made to segregate investment banking from commercial banking. The real estate commitments are being reduced. The regulation of interest rate on deposits is another novel feature, Member *banks cannot directly or indirectly pay interest on deposits payable on demand.* The *F. R. Board has to fix interest rates on time deposits.* See " the Changing Structure of American Banking" by R. W. Goldschmidt, p. 251. See my article. "Some Recent Banking Measures of America and their Lessons for us, Ganga, Oct. 1936.

[13] The Reconstruction Finance Corporation is now owning a large *block of preferred shares* in a number of reorganised banks. The emergency loans are converted into preferred shares in case of 4,000 *banks.* See the Financial Times, 3rd August, 1933. See also Memorandum on Commercial Banks, p. 261 (1925-33).

himself,[14] while other Governments considered it wise to throw their shield around every bank. According to Hartley Withers " it is not good laws but good bankers that produce sound banking."

While the English economists and bankers object to a normal amount of control, help or interference on the part of the Government it must not be considered as an aversion to state help during abnormal times. They incline to the opinion that the Government should stand " behind the banks " and protect them on emergent occasions. Whenever a crisis appears the Bank of England is expected to increase the note-issue and take care of all the sound institutions by providing them with note currency. Even before the passing of the Currency and the Exchange Act of 1914 in England, the quasi-legal understanding in the British community was that the Bank Charter Act of 1844 would always be suspended during exceptional times of grave anxiety. The recent Bank Note Act of 1928 has given the Bank of England full freedom to secure elasticity to satisfy legitimate demand for credit and render impossible at the same time monetary inflation.

During the period of the recent war new measures were adopted to save the banking situation in almost all countries. In England steps were taken to protect the joint-stock bankers, acceptance houses, bill-brokers and the stock-brokers. In short the different constituent members of the money market were supported. Such was the paralysis with which business was affected. Neither the usual method of suspending the cash payment as was done during the eventful years of 1792-1820 nor the mere suspension of the Bank Charter Act of 1844 as was resorted to during the years of 1847, 1858 and 1866 would alone have saved the situation.[15]

The Government of India follows closely the foot-steps of the Government of the United Kingdom. The English Bankers, *i.e.*,

[14] See the late G. H. Pownall's inaugural address as President of the Institute of Bankers, 1916.

[15] It is not the aim of the author to describe the causes of the crisis in 1914 nor treat the various remedies in detail that were taken to remedy the situation. For a graphic description of the crisis, Hartley Wither's book, " War and the Lombard Street " can be consulted and for the various measures adopted an authoritative account can be obtained from A. W. Kirkaldy's " British War Finance."

the founders of the Agency Houses[16] taught joint-stock banking business to the Indian people As Prof. Dicey says, "the Englishmen carry their common law with them wherever they go" and English bankers in India can hardly be expected to be more docile by submiting to banking laws. As a result of this facts general banking laws regulating banking business are few even now in India.

The Government of India circularised[17] the various Provincial Governments inviting suggestions for banking legislation in 1913 but with the advent of the late war the question was practically shelved. The different Chambers of Commerce were approached and the majority of them inclined favourably towards banking regulations on broad and general lines. From a recent circular one learns[18] that the Government of India wishes to pass legislation making it compulsory for every Indian joint-stock bank to publish monthly its own operations according to an approved form of balance-sheet. Beyond it they have declined to proceed further.

Even China "the house of strife, of flouted authority, of widespread disintegration and of national penury" is making rapid strides in the matter of her banking business. Before the recent war banking business was nothing but a pawn-broking profession. The native bankers never helped the Chinese Government with loans intended for the development of railways, industries or national development and re-organisation purposes. But with the closing of the foreign markets in the recent war the Chinese Government had to cajole the leading native bankers and quite a profitable business was done by the Pekin banks in financing the Government at 15 to 20% rate of interest. There was then a rush for banking business and various guilds are now financing themselves by starting banking firms of their own. So to-day one finds Silk, Agricultural and Labour Banks. Chinese Banks were established even in foreign countries, *e.g.*, Sino-French Bank, Sino-American Bank, Sino-Italian Bank, Sino-Belgian Bank, Sino-Danish-Norwegian Bank. The starting of the banks had an appreciable influence in bringing about peace, order

[16] Many of them were the Directors of the Bank of England during the years 1813-29 and effectively shaped its policy.

[17] Letter No 6905, dated 22nd August, 1919. The Department of Commerce.

[18] Letter No. 807, dated 12th Nov. 1920. The Dept. of Commerce and Industries.

and tranquillity.[19] The Chinese Mandarins and the medal-bedecked *tuchun* have given up civil war as their profession and are undertaking banking business. These newly started ventures are agitating for legislation to help them and smooth their progress. The second United Chinese Bankers' Conference at Tientsin passed resolutions inviting legislation in the matter of issuing notes, bills and cheques. It pleaded for the abolition of the *tael*,[20] and recommended the use of the dollar in its place. It pleaded for the abolition or at least exemption of transportation fees on all bank notes and specie payment from one bank to another. It pointed out the necessity of stopping the minting of old silver and copper currency. It agitated for the recognition of the existing Clearing Houses and Banking Associations in the country. It recommended the starting of a bureau of information to ascertain the financial standing of business firms on the lines of the Dun and Bradstreet and give them an official rating as the American reports do, or failing this, to establish an enquiry bureau on the model of Stubbs or Seyd or Shimmelpfong. It requested the State to establish a standard technical terminology for banking business. The Foreign Bankers' Association of Shanghai is closely co-operating with the Chinese banks to secure the above reforms and an International Banking Association is to be started shortly. Quite recently the Central Bank of China has been created to operate as a national institution and is doubtless meant to help the reformation of the Chinese currency situation.

Although India does not stand so disorganised and bankrupt and is not in such a morass of helplessness as China, the Indian joint-stock banks can emulate the zeal and enthusiasm shown by their Chinese contemporaries.

[19] Twenty years ago there were only 2 or 3 sound banks but there are now more than 100 of them, with more than 350 branches. For 41 banks which reported details to the Shanghai Bankers' Association in 1921 the total asset s amounted to about $400,000,000 gold and the deposits amounted to about $ 210,000,000 gold.

Thus the situation is a great improvement over conditions prevailing in 1900 and the present Commission for the adjustment of national finance is attempting to devise measures for the amelioration of the public debt, the preparation of a budget and the adoption of a sound currency system.

[20] The Guan Shikal Dollar is circulating all over the country. The old time dependence on French, Spanish and Mexican coins is no longer felt.

It was only recently that Japan thoroughly overhauled her banking system and all the ordinary banks and savings banks have been subjected to legislative enactment. The same has been the case in the reorganisation of the banking system in Poland. The recent Krueger Crisis led to an intensive development of state legislation with reference to banks in Sweden.

During the years 1925 and 1926 Spain introduced banking regulations inaugurating a Banking Council whose function is to publish quarterly all banking statistics and lay down conditions under which banks may operate. Thus the Council has the right to fix a minimum capital for each bank, taking account of the size of the place where itoperates ; to determine the relationship which must be maintained between the capital and reserve funds of each bank and its sight liablities ; to set a maximum interest rate for deposits, bonds, etc. ; to fix the proportion which must be maintained between sight liablitios and immediately realisable assets ; and in general to regulate the business of banking.[21]

In the recently established Bolivian Republic commercial banking law of a most detailed character extending from the capital of the bank down to the making of loans have been passed in 1920.[22]

The Mexican banking system which has recently been reorganised in 1924 and 1931 and 1932 makes provision for the establishment of a National Banking Commission and the creation of new banks as well as the supervision of *old ones* is its main *duty*.

The Columbian Banking Law of 1923 makes provision for the legal control of banking business. Every aspect of commercial banking business is rigidly controlled and supervised by the Government.[23]

The banking law of Chile defines the new conditions under which new banks, national or foreign, can be established and it lays down special rules to be followed in case of failure, liquidation and temporary suspension of payments on the part of a bank.[24]

Coming to Brazil similar detailed regulations are to be enforced in case of banks dealing in *exchange*, and a system of exchange

21 See Memorandum on Commercial Banks (1925-1933), p. 189.

22 See *ibid*, pp. 274, 276.

23 See the Memorandum on Commercial Banks, p. *379*. (*1913-1929*).

24 *Ibid*, p. 371.

control has been in operation since 1921. Foreign banks are subject to supervision by the Inspector-General of Banks. Their bye-laws, lists of shareholders, etc., have to be presented to the Minister of *Finance*.

In Norway the Banking Act of 1924 attempts to strictly define commercial banking business and control their operations. One special peculiarity is that depositors of banks are entitled to elect one-quarter of the Board of Directors of a bank while the shareholders elect the remainder.

Supreme controlling powers are placed in the hands of Central Bank and the Bank of Italy has to secure the observance of all banking regulations.

The little country of Denmark does not fail to provide for a thorough-going set of regulations governing the commercial banks. It makes provision that a Managing Director of a Bank may not be a member of the Board of Directors. It also insists on the fact that the bank director of one bank cannot act as director of another commercial or savings bank.

Special Circumstances of India

Several prominent non-officials in this country suggested legislation for the better management of banking business.[25] Discussion keenly centred round this pivotal point after the failures of the Indian jt.-st. banks. There is a consensus of opinion in this matter and the necessity of enacting sound legislation as a possible safeguard against further failures and a repetition of past disasters must be acknowledged by the bankers and recognised by the Indian public. The recently appointed C. B. Enquiry Committee recommends the enacting of a special banking act.

[25] Every witness before the I. I. Commission who was competent to speak on banking matters advocated legislation. The only solitary exception is Mr. Nandlal Puri who considers the Jt.-St. Companies Act of 1913 as an efficient and comprehensive measure. The Hon (now Sir) T. Smith of Allahabad wanted the definition of the word "*bank*" and a limitation of its use to protect ignorant people. Sir Stanley Reed in his evidence before the Babington Smith Committee wanted that all small banks should be closely supervised by the Government. The subject of banking legislation also received great attention during the Indian Industrial Conferences—of 1913 and 1914. But there was no thoroughly conceived plan of reform advocated by any of these reformers.

At present there is very little of banking legislation in this country. The Government of India committed the fatal blunder of requiring all companies, banking as well as trading to be incorporated under the same Act, *i.e.*, the J. S. Companies Act of 1913.[26] They have shown a deplorable lack of banking ideals in permitting the authorised capital of a bank to be much larger than its paid-up capital thus tolerating inadequate banking capitalisation. An undue prolongation of the paying-in of capital is another short-sighted policy allowed by the Government. The paying of dividends out of actual capital or when a substantial reserve has not been accumulated is not prohibited. The character of bank loans has not been defined. The granting of too large a proportion of the loanable funds of a bank to individual borrowers is also permitted. No definite cash reserve is stipulated. The advisability of legislating to get a better security of deposits has not been considered. There is not the least semblance of an independent bank examination on the part of the Government or of the Clearing House. Not much of publicity is insisted upon.[27] Only the loans of a bank have to be divided under

[26] Even in the matter of the J. S. Companies there is considerable laxity in the observance of the 1913 Act. Even though breaches of law are detected and prosecutions launched, summary punishments for these lapses from the ordinary commercial morality are not usually imposed on the offenders. Registered banking companies are often liquidated and are almost immediately registered again under new names but with the same directors as before. Leniency in the matter of enforcement of the Act is no encouragement of the jt.-st. enterprise and the interests of the shareholders should always be safeguarded. The attitude of the Government of the United Kingdom towards jt.-st. companies would undoubtedly be changed in the light of recommendations of the Company Law Amendment Committee. It is proposed therein that no company can be registered with the name "Bank" without the consent of the Board of Trade. It is also recommended that provisions as to directors' liabilities should be extended to the auditors of the Companies. It objects to the practice of articles which exempts directors of companies from legal liability for negligence or misfeasance. There are other excellent recommendations referring to the practice of the jt.-st. companies in England which the Indian Government would do well to note. (See the Journal of the Institute of Bankers of the United Kingdom), March, 1927, pp. 136-139 Now that the I. Companies Act is going to be revised it is worth while to stiffen the regulations in several directions. After all the new Companies Act of 1936 has not established a new banking code. A more informing balance sheet, the compulsory formation of reserve fund and the accumulation of cash reserve are the points in which the banking law has been stiffened.

[27] The Registrar of the jt.-st. companies has to be furnished with a balance-sheet of the Company annually along with the Register of shareholders, *vide* the Indian Companies Act of 1913.

certain headings and detailed information has to be given on this point.[28] There is no power to call for any special return from the banks.

Special Reasons for Banking Legislation.

Banking business conducted on the joint-stock principle is quite new to the Indian mind. Having become familiarised with the stable private banking houses of the indigenous bankers, the Indian people in the smaller cities and places view joint-stock banks managed by outsiders with some apprehension. The recent failures made them all the more suspicious. Even though there be few joint-stock banks there is no reason why the banking regulations should not be stiffened.

General banking laws are not required to provide the proverbial 'strait-jacket' for our banks but only to inspire the public with confidence. Confidence is the breath from which the banks draw their very life. While giving the necessary freedom to the banks to make their business flexible and adaptable to the business needs of the community, the general banking laws should forbid the banks to venture out on other fields than banking.

The Government should take the initiative in this matter. Neither the fewness of our banks, nor the fact that they are managed by trained Westerners must stand in the way of official regulation of our banking business. The apathy of the existing Indian joint-stock banks is hardly creditable to them. So long as they are doing sound business no official regulation hinders them. On the other hand it will help them to a great extent in creating confidence in the minds of the people. Education of the masses as to the utility of the bank and their services is a slow process. It takes several years to create that confidence in the minds of the Indian people. Official regulation will accomplish the same in a shorter time as the Indian people have a touching belief in the potency of official law.

It is undoubtedly true that "there is no legislative road to banking paradise" as one English banker puts it. Legislation may not

[28] The particulars required by the Act of 1913 are given in Form G Third Schedule—Indian Companies Act of 1913. Sections 4, 32, 132, 138, 145, and 259 alone refer to banking companies.

be the panacea for any of our banking ills. Government control and inspection may not prevent banking failures. It is indeed true that many of the National Banks of the U.S.A. failed in spite of detailed banking laws and rigid government control.[29] It is quite likely that the machinery of government will not produce a competent staff to supervise the various banks in an effective manner. It is absolutely certain that control emanating from within by the depositors, by the shareholders and by the customers will be more effective and valuable than control from without by Government-appointed examiners.

Good directors, good officials and good auditors can accomplish more than any sort of ideal regulations. However, it must be recognised that much benefit will result from sound banking laws. The newly started banks can derive invaluable aid from these restrictions. Some banks finding nothing to hinder them in the shape of laws may become 'adventuresome' and tie up the depositors' funds and come to grief. By all means the banks should be progressive and display the pioneers' willingness to turn their hand to whatever comes in their way.

[29] The following table shows the banking failures in the U.S.A. :—

Year.	Total No. of Banks in existence in June.	Banks closed.			Banks re-opened.		
		No	Deposits.	Capital.	No.	Deposits.	Capital.
			Million $.			Million $.	
1919	29123	50	17	...	...	...	...
1921	30812	501	196	23	60	17	2
1923	30178	648	189	22	37	12	2
1925	28841	612	173	24	62	17	2
1927	27061	662	184	25	95	36	4
1929	25330	642	235	32	58	26	3
1931	22021	2298	1759	208	271	158	19
1932	19163	1456	730	...	290	276	...

See *Table 27*.—R. W. Goldschmidt—"The Changing Structure of American Banking."

They should adapt themselves to the changing requirements of their customers but this does not mean that they should play fast and loose with "other people's money."

The Government, so long as it defines the nature of business that a bank has to do and imposes ordinary restrictions which the banks themselves have to arrive at for the proper conduct of their business, should be regarded as doing its legitimate duty and cannot be said to transgress the freedom of bank officials. The Government should see that thrifty people do not suffer by entrusting their savings to bogus banks. Only the Government should not make the banks instruments of its own and incline to the pernicious idea that "the best way of creating money is to borrow it."

Government legislation may be unnecessary in the case of highly advanced countries where the banks themselves understand their legitimate business and where the public are alive to their responsibilities. But in backward countries where banking ideals are not crystallised legislation is not unnecessary. The banks will be new to their business, the public ignorant of their duties and many a pitfall can be avoided by following the straight and simple rules laid down by the Government. It is folly to leave everything in amateur hands to regulate their business by the quantum of their own limited experience or the inadequate bye-laws they may pass for themselves.

Again Government legislation may be unnecessary when all the directors of the banking companies actively participate in the management and framing of the bank policy and when the directors or managers are not allowed to participate in the management of other companies at the same time without any official sanction. But the real fact is that several of the smaller Indian joint-stock banking companies are working under the well-known managing director system and the managing director initiates the policy, carries it out and is mainly responsible for the final results. The other directors are mere figureheads easily dominated by this personality and though it must be recognised and acknowledged that these managing directors do not possess criminal intentions, yet their descent to Avernus is made possible by the absence of strict laws and actually facilitated by the co-directors who do not realise their own responsibilities. It is a mistake to think that the duties of bank directors end by merely safeguarding the interests of the shareholders. They are trustees for the depositors

also and must pay attention to public interests and should not hesitate to reduce dividends when such a course of action is deemed essential in the interests of the depositors.

Even in England the long series of defalcations of clever and astute financiers during recent years Zabez Balfour, Whitacker Wright, Hooley Farrow, Bottomley and Bevan—is drawing the attention of the public to the defects of the Company law and public opinion seems to incline to the view that the English Company Law relating to the duties of their auditors, the details of information to be published in their balance-sheets and the form in which the company prospectuses should be published must be carefully defined and strengthened.[30]

Some sort of protection must be given to bank depositors for much reliance cannot be placed in the reserve liability attached to the bank share. It is essentially an English practice which has been copied here, but the question of collecting the unpaid portion of the bank share in times of necessity is no easy task. India is a vast continent of great distances and the joint family means joint rights of property and the civil judicial procedure is proverbially slow. All these tend to place great difficulties in the matter of realising the unpaid portion of the bank share.

Legislation may defeat its own object or may place troublesome shackles barring the path of the intelligent bankers well versed in the soundest traditions of safety and gifted with a long-sighted view of the real requirements of the nation. But unfortunately for India her roll of distinguished bankers is very limited. Except the late George Dickson who originated the amalgamation idea of the three Presidency Banks and the late A. M. Lindsay who foreshadowed the application of the gold exchange standard system to India and who had the adroitness to prophesy that "his scheme will be accepted by the Government in spite of themselves" the rest of the bankers had only chequered ideas and half-enlightened notions on the banking needs and requirements of our people. Banking business should no longer be considered solely as a profit-making endeavour and the interests of the shareholders should not always predominate. Banks are endowed with the dignified prerogative of creating credit. Not only should

[30] Since these lines were written the 1929 Company Amendment Act was passed in England carrying out most of the above suggestions.

they make a sound and proper use of credit but they should prevent, as far as it lies within their paser any unfair use or abuse of credit. This prerogative should be exercised for the real benefit of the community leading to a full and wise economy of precious metals, extending production, enlarging manufactures, and increasing trade and commerce. National interest and national benefit should be the actuating motives of the Indian banker.

When again there is no enlightened public opinion to chastise the shortcomings of the bankers or to effectively demand rapid development of sound banking facilities it is not wise to expect that everything would go on without a hitch. Advocacy of banking legislation rests not on the view that it is a panacea or substitute for prudent banking but on the sole belief that it affords the best basis for a sound banking and business economy and the surest safeguard for the stability of the currency.

The Government of India should realise that the real power of the banks is being blindly exerted in the direction of profits to the shareholders alone and that several of the smaller banks which are more numerous than the larger banks are not being controlled calmly by perfect knowledge. This is no insinuation against the present bank managers that they have expanded the quantity of bank credit out of all proportion to the general economic expansion of our country or that they have built up a huge credit structure on a small basis of cash reserve as is the case with the English banks. The sole contention is that the small banks are too anxious to attract business and they set at naught wise and prudential principles that should govern the supply of credit. For instance the supply of credit for buying fixed capital is discountenanced by all banking experts and financiers but some of the Punjab banks which failed in the crisis of 1913 to 1915 lent too much money to the cotton-ginning factories, out of all proportion to the cotton-producing capacities of the province.

Some of the present banks are evidently anxious to bring about a rapid industrialisation of their provinces, thinking that banking credit alone would enable the raw materials to be successfully manufactured into industrial products. Although credit facilities are solely needed it must by no means be concluded that banks should dispense with the following points in the matter of granting credit. The business capa-

city of the applicant, the prospects of an early repayment of the loan, the general political situation, the reliability and commercial standing of the applicant, and lastly the banks' own financial position should be always kept in mind by the bankers. Loans to small traders who are unable to produce good bankable securities and to small manufacturers who cannot show orders from good firms or invoices of goods already sold and ready for despatch are unsound and these rules never loom large in the minds of the small joint-stock bankers of this country and as a matter of fact several of these combine trading with banking business. Some of the Bombay banks finance speculators on the Stock Exchange or cotton, grain or bullion market on a very extensive scale. The smaller joint-stock banks are nothing but mere money-lending institutions bearing the honourable caption of "banks."

Although credit has not been put to any serious misuse in this country yet the proper husbanding of our credit material and the correct use of it is not to be seen in the case of the small banks. It must be understood by these banks that credit is one of the factors indispensable for increasing the wealth of a country and so long as credit increases the supply of commodities it tends to cancel the tendency for prices to rise. Hence if the loans and discounts of our banks actually augment the stream of commodities flowing into the hands of the community its actual wealth increases and a right use of the credit is made by the bank. But if our banks succeed in placing credit in the hands of those who fail to increase production they would be rendering a fatal disservice to the community, firstly by the misdirection of credit, secondly by raising the purchasing power of money in the hands of the people which tend to raise prices and the tendency towards increasing prices is not counteracted by increased supply of commodities and lastly they are endangering their own financial standing by entrusting their resources to the incapable and undeserving producers to whom no quarter should be extended.

Suggestions for Banking Legislation.

It is indeed a matter of deep concern and profound regret that the Government of India have not turned their serious attention to this

subject. They have all along been upholding [31] the vested interests of the Imperial Bank of India and the Exchange Banks which display no grain of sympathy with their newly started rivals and the Government of India sat with folded hands while even some of the sound Indian joint-stock banks were forced to suspend their business during the crisis of 1913-15. Perhaps the moral responsibility to help the poor public did not weigh sufficiently strongly with them.

Every western economist of reputation repeats the hackneyed opinion that Indians are prone to the hoarding habit.[32] The Government of India relies on this opinion but yet takes no remedies to enable the people to divorce this habit. With the exception of the stipulation that the Imperial Bank of India should open a hundred branches within five years of its starting and the increase of capital they have insisted upon which certainly will help their own financial business, they have not taken any other worthy measures to effectively counteract the so-called "hoarding habit" if it really prevails among the Indian population. They have not expanded even up to the present day the savings banks system in any way to suit the convenience of the public at large.

It is of no use to blame the illiterate people while effective measures are not being taken to wean the people from the pernicious habit. Neither have they induced the people by allurements to deposit money in the Postal Savings Bank nor have they protected them when bogus banking companies were inducing them to deposit their money

31 Upholding of the monopoly of the Exchange Banks was considered a grievance by the shareholders of the Imperial Bank. The Reserve Bank has now to provide sterling exchange to any individual according to a clause in its charter. The refusal of the Government of India to deposit their money in the Indian joint-stock banks is one grievance and it is an evidence of partiality towards the Imperial Bank of India. A sort of preferential treatment is meted out to these banks.

32 Only the recent Sir H. B. Smith's Committee has grasped the truth and it says that India's use of gold as a store of value is justifiable in the absence of savings facilities' It also points out how the use of gold in social ceremonies is sanctioned by tradition and usage— para. 63. See also the Reports of the External Capital Committee—para. 8. See also the Reports of the Royal Commission on Indian Currency and Finance, 1926 (paras. 64 and 68)—the Interim Report of the Gold Delegation Committee of the League of Nations (pp. 13 and 14; and Report of the C. B. Enquiry Committee, p. 437. See also the Reports of the Controller of Currency (1929-30), para. 12.

in their vaults. On the other hand the banks are finding it increasingly difficult to attract deposits from the people as the Government is attracting all available savings by paying 5 to 6 per cent. rate of interest for all its loans and treasury bills it raises in the money market. Sir Dorab Tata referred to this fact [33] and complained bitterly of the impossibility of the Industrial Banks ever hoping to pay such high rates to their depositors in the expectation that a still higher rate can be realised from the industrialists

If the attitude of the Government of India towards banking business in normal lines is hardly inspiring their attitude in abnormal times is hardly worth mentioning. In Canada and the United States of America the Federal Governments undertake the duty of converting the notes of a failed bank and this Government guarantee is a virtual protection against their depreciation. Their general understanding is that " Government is behind the banks." In India however there is a vague responsibility, according to Mr. J. M. Keynes, lying on the shoulders of the Government of India to come to the rescue of the banking system in the event of a widespread failure.[34] When the clock of banking progress received a rude check in the crisis of 1913 to 1915 very little was done to alleviate the situation. In future at least the Government or the Reserve Bank should undertake the task of resuscitating and reviving the business of sound banks when they meet with any calamity. In order to better perform this task the Government should undertake to introduce some amount of control by legislation, inspection or other means even during normal times. The Government of India should only remember the adage that " it is never too late to mend." Its recent decision [35] to postpone legislation

33 Owing to the inadvisability of conducting industrial financing with money borrowed at a high rate the Tata Industrial Bank has transferred its industrial business for the present. What led them to this decision was that the rate of interest which the Government are prepared to pay for loan and treasury bills coupled with their continued necessity for keeping in the market will militate against any industrial bank obtaining necessary funds for industrial business. Since the above was written the Tata Industrial Bank has been amalgamated with the Central Bank of India.

34 See his Memorandum on the State Bank appended to the Final Report of the Chamberlain Commission.

35 Letter of the Department of Commerce and Industries, 17th November, 1920 (Letter No. 8071).

should be revoked and it would be highly expedient if it bears in mind the suggestions outlined below. " To expect the nation to work out its own banking salvation by means of its own experiments and its own experience " is unwise economic statesmanship.[36] Therefore a special Bank Act containing the following provisions should be passed.

" Bank."

The word " Bank " should be restricted in application only to those financial companies which undertake to meet all obligations on " demand " and subject themselves to be drawn upon by means of cheques. It should be denied to bogus and unsound companies with a large inflated nominal capital whose sole desire is to exploit the public under the patronym of the word "bank." It is indeed difficult to define the word "bank" and banking legislation should not be extended to those indigenous bankers who do not burden themselves with others' money to any extent as joint-stock banking companies do and who do not propose to shed other lines of activity. The proposal of the C. B. Enquiry Committee is to restrict the use of the word only to those who are members of the Banker's Association.

Capital.

In the matter of banking companies the authorised capital should never be allowed to be higher than 4 to 6 times the paid-up capital. It would not be unwise if the Government of India were to set up a minimum limit to the banking capital which should be declared necessary for a certain amount of population, taking into due consideration the character of their business and their demand for credit.[37] If an

[36] Sir James (now Lord) Meston refused to consider the question of banking legislation on this pedantic plea.

[37] The Fascists of Italy who are controlling their banking organisation thoroughly contemplate the granting of power to the Bank of Italy, the Central Bank of Issue, to examine the situation before permitting any new bank to be started in any locality. Over-capitalisation or under-capitalisation are thereby avoided.

One reason for failure of rural banks in the U. S. A. during 1931-1933 is the starting of too many banks and banklets although either population or its commercial demand for credit has not *increased*.

See the Federal Reserve Bulletin, 1933, p. 225.

adequate amount of capital is to be had from the beginning all temptation to tout for business would be removed. It would also be wise on the part of the Government of India to stipulate that of the subscribed capital half should be paid up at the starting of the banking companies' actual operations.

Provision should be made that a substantial part of the balance should be paid within six months of the registration of the banking company. Much benefit would also accrue if permission is denied to the banking companies to parade the amount of their "authorised capital" in their balance-sheets. Only the subscribed capital and the paid-up capital should be published. If any amount of reserve liability is attached to the bank share it should also be published. Otherwise the fact that it is a fully paid bank-share should be mentioned. No real benefit can be reaped by publishing the "authorised capital" of the bank. The ignorant public, who do not very often possess correct notions as to the real difference that exists between the three items are apt to be led astray by these figures. If permission is given to the publication of these various items all of them should be printed in the same attractive type.

Licensing of Banks.

Either a supreme banking council or the control department of the Reserve Bank should be created to issue licenses to all the existing banks, Indian or foreign and create new ones after the terms of the license are complied with or adhered to.

While prohibiting the combination of trading with banking business the aim of the controlling authority should be to secure a proper geographical allocation of trade areas to the different Indian joint-stock banks.

All the Indian-owned joint-stock banks should have a majority of natural-born Indians or domiciled Indians on the Board of Directorate. The managing agency system which is so baneful a feature of company management in India should not be introduced in the case of banking management. The Managing Director need not essentially be a member of the Board of Directorate. The Bank Act should specifically prescribe the qualifications, the method of appointment and retirement and the voting powers of the Directors.

Apart from maintaining an up-to-date register of shareholders the voting rights would have to be vested in the hands of registered members only and the abnormal delay attendant on the transfer of shares has to be discountenanced by laying down that after a period of six months alone as registered shareholders is anybody to be entitled to vote.

Directors.

Many of the smaller banks award the directorship to influential people who are likely to bring business and lend to the bank a colour of respectability. Many of these do not possess the technical knowledge for the management of banking business. Generally they have neither the leisure nor the qualifications for handling efficiently the problems of our banks.[38] This inefficiency must be put an end to as early as possible. Although we have come across the tendency in some countries to appoint only people possessing adequate banking knowledge as bank directors it is difficult to insist on such a step and subject these people to a compulsory examination before being appointed as directors. But much improvement can be secured by enacting that it will illegal to appoint directors who already hold half-dozen directorships in trading or other kinds of joint-stock companies. This tends to make the director consider his position as a pleasant semi-sinecure one and he makes no effort to interfere in the management of the bank.[39] One of the salutary reforms approved by the recent Commission on banking reform in Japan was to prohibit bank directors or other officers from serving as directors of any other business concern.

Even in England the general public would not permit the bank directors from undertaking the work of managing other companies as it would curtail their time and energy towards the business of the bank.

[38] See the evidence of the Directors, Messrs. Deoton and Abdulla of the Agricultural Bank of India in the criminal case against Shankar Lal, Managing Agent, before the Special Magistrate of Bangalore. The floatation and everything else regarding the bank was left to Shankar Lal and the Directors were induced to join on the pretext that high financial support or backing has been secured.

[39] The second advantage would be the preventing of industrialists from securing control over the bank. That such a thing would be disastrous can be easily guessed by the example of the Alliance Bank of Simla.

In 1926, Mr. R. McKenna was very adversely criticised for having accepted a seat on the Board of Canadian Pacific Railways.[40] A bank directorship means enough responsibility and when it entails full demands on the time of the director it is sheer folly to accept seats on other boards of industrial concerns.

If the law makes it possible for the depositors to elect their own representative possessing special qualifications in banking, finance, and investment it would go a long way in securing the needed efficiency. If it is considered inconvenient to allow the depositors to interfere with the daily management of the concern a Supervisory Council, wherein the depositors and other shareholders might be represented, must be created by every bank [41] There must be quarterly meetings of the Supervisory Committee or Council to cross-examine the work of management andto make the appointment of qualified men for the higher appointments in the banks. Many of the grave abuses incidental to the present Board of Directors of the smaller banks can be remedied by vigilant action on the part of the Supervisory Committee. The value of the Supervisory Committee to the business of a bank would be very great.

The rights of the shareholders and their voting power have to be defined carefully. The holding of proxies by the officers of the bank is liable to great abuse. The admissibility of thegeneral form of proxy and its direction ought to be definitely settled by the Bank Act. The majority of the shareholders should be Indians.

Reserve Fund.

The Government of India should compel the banks to build up a decent reserve by setting aside a part, say 1/15 of the annual net earnings of the banks, till the reserve fund amounts to half or whole of the paid-up capital and then alone should the banks be permitted to distribute their entire funds as dividends to shareholders. The law should also aim at prohibiting the banks paying dividends when

40 See the Banker's Magazine on McKenna's accepting the above seat, September 1926, p. 178.

41 Such a practice of appointing a Council of Supervision exists in the case of all public companies in Germany.

substantial reserves have not been piled up or when bad debts have not been completely written off. It should also be the aim of the law to see that if any of the special Reserve Funds are invested in securities only gilt-edged securities are selected for this investment.

A concealment of the bad debts is usually wilfully and knowingly done at the time of the preparation of the bank balance-sheet. This might not be done with a dishonest intention and due provision might be made out of the Reserve Fund for that full amount of suppressed bad debts. As this act however violates the form according to which the balance-sheet of the bank is to be published it amounts to a legal offence. Of late, this kind of provision is no longer considered a legal offence.

The formation of " hidden " or " secret reserves " has to be encouraged for these can act as a buffer for meeting unforeseen losses without operating on the published *reserve fund*. As it is the usual practice for Bank Managers to consider the minimum legal provisions as maximum ones and make no other preparations to fortify the banking position the formation of secret reserves has to be encouraged.[42]

Acceptance business.

Now that it is the aim of the bank reformers to develop bank acceptance business it is essential to see that there is no danger arising out of this business. Accepting bills of exchange by the smaller banks would always be a danger. Hence banks not possessing 5 lakhs of rupees paid-up capital should not be made to accept bills of exchange. Accepting banks which do not possess a decent amount of paid-up capital should not be made to accept bills of exchange. They should not only possess a decent amount of paid-up capital but the volume of acceptances outstanding at any time must be equal to their paid-up *capital plus reserves*. It must be laid down clearly that the amount of acceptances for any individual firm or company must also be limited. If banks accept bills under such salutary regulations it may be possible to find buyers for the bank acceptances. Slowly and steadily a bill market would arise and if rediscounting at the hands of the Central Bank of Issue is forthcoming the development of an open market for bills can be easily secured in this country.

[42] See my book, " Elementary Banking,"—chapter on the Balance-Sheet.

Banking business.

It has too often been noticed that our small banking companies combine trading and other functions along with legitimate banking operations which are bill discounting, loaning and attracting of deposits. The law should prevent such a combination and the Registrar of the Joint-Stock Companies should be empowered to delete from the Memorandum and Articles of the Banking Company all clauses that may be considered as running counter to the interests of the public or it should be restricted from performing functions which are not usually conducted by banking companies elsewhere. To prevent the Registrar from being the final arbiter in all such cases an appeal should be allowed to the judicial authorities in all matters of doubtful decision.

Criminal punishment.

There is an urgent necessity for the tightening of the criminal law making the directors, managers and the auditors of the banking company personally liable for deliberate fraud practised on the company or a wilful and a deliberately fraudulent maladministration of banking funds.[43] Those auditors who certify the different balance-sheets negligently or knowingly in most cases and state that everything is correct should be taken to task and the auditors' section, 145(2), of the Indian Companies Act must be reformed and heavier penalties imposed in all these cases. On the other hand their power to call for more information and properly assess the value of the different assets should be strengthened.

Savings Bank business.

It has become the common practice prevalent among the Indian joint-stock banking companies to attach a department for conducting savings bank business. In all such cases, the law should compel the

[43] It is only in the recent Punjab Industrial Bank affairs that the ex-director, Mangal Seth, was given exemplary punishment for his falsification of accounts and criminal breach of trust of sums involving lakhs of rupees. The total period of imprisonment served out to him was about 18 years. Such a deterrent sentence would prove a valuable eye-opener to the directorial "crook" who is often responsible for bank failures.

banks to invest half of the sum secured in the savings bank business in securities approved by the Indian Trust Act and these should be ear-marked for that purpose. The savings bank business, if properly developed, will help to create a banking habit in India.

Cash Reserve.

It may appear a ludicrous inconsistency if no regulations are outlined with reference to the holding of the cash reserve of the banking companies, specially after what has been written before under the heading "the rationale of banking legislation." The omission of any laws as regards the cash reserve is justifiable if the other banking operations are conducted according to the regulations outlined here.[44] Such a wise transaction of the other banking operations will render unnecessary a large cash reserve and if the assets chosen are liquid and easily realisable with minimum of loss to the banker a smaller cash reserve will be found sufficient. Although a legal regulation of the cash reserve can be easily justified on principle yet it can be better regulated if the hands of the bankers are unfettered in this direction. If mutual help is forthcoming as the result of an *esprit de corps* prevalent among the bankers it will enable the bank to pull through an emergency except that of a "concerted run" and in the event of such an unforeseen contingency no amount of cash reserve will likely prove sufficient.

Credit-wreckers.

No amount of legislation against credit-wreckers would be of any avail if the bankers do not conduct conservative banking and keep their assets as far as possible in a liquid state. The suggestion of the Ceylon Banking Enquiry Committee in this direction seems worth a trial. It says that in order that banking enterprise may not be withered by blasphemous reports and *mala-fide* complaints a procedure is suggested whereby a preliminary enquiry would be held by the Registrar of

44 It is gratifying to note that Prof. Gustav Cassel recommends the same measure before the Gold Delegation Committee. But this Committee rejected this suggestion. See Final Report.

Joint-Stock Companies and the offence would be triable by the Magistrate only if such an inquiry gives the necessary permission. It adds that " alternatively the defending bank should be reimbursed with its costs in case of vexatious proceedings by the complaint and the latter should be required to make a deposit in court in advance."[45]

Loans.

The law should permit the banks to lend money to their directors, managers and members of the banking staff only on the strength of securities and not its own bank shares and at such rates as are charged to the other customers of the bank. The law should make it compulsory that if the directors or industrial companies in which these directors are interested apply for loans, they should not be permitted to attend the Board of Directors' meeting lest their presence may induce the co-directors to vote for the loan. The banking company should be prohibited to grant money to its customers on its own bank shares and upon other bank shares if a large portion of them is unpaid. Loaning on real estate should be prohibited but the bank may be permitted to entertain real estate in the event of the depreciation of an original security tendered as cover for the loan. It is a matter of sincere gratification to note that the Investigation Committee of the Bank of Mysore appointed to examine the advances made to the bank directors has recommended that a limit should be placed on the power of the bank up to which it can advance within the value of the securities pledged.

The law should restrict the amount of loanable money to individual borrowers to a limit of 25% of the capital of the bank and if more advances are needed they should be made on actual consignments, taking care to hold the bills of exchange and their attendant documents as security or the actual deposit of recognised securities accompanied with a letter of hypothecation.

Advances to the bank auditor should be prohibited—though security might be offered for the said loan.

45 See *the Statesman*, December 12, 1934.

Banks' borrowings.

The banks should on no account be permitted to borrow indiscriminately. The mortgaging of uncalled capital of the bank should be prohibited for it is the only unrecognised security of the Bank's creditors.

Investments.

The law should be wise enough to restrict the banks from having too large a holding of one kind of security as basis for a loan—though it be a Government security. The banks should be permitted to invest in Trustee Securities and as industrial securities are purely of a speculative character there should be an attempt to prohibit the commercial banks from holding too many of such industrial securities.

The rate of interest from these investments should not be lower than what is actually paid for money borrowed and as all such investments are unsound finance the banking companies should not be permitted to invest too freely in them. The valuation of the investments for balance-sheet purposes is to be at cost price or market value whichever is the lower.

Balance Sheet.

In accordance with Form III, Schedule G of the Indian Companies Act every banking company incorporated under the Act has to publish details of its business operations. But this form is not at all a detailed one.

The particular items of the different banking operations should be amplified and set out in a greater detail. A frequent publication of a balance-sheet will secure the confidence of the depositors and the general public who may like to transact dealings with Banking Institutions. Such publicity would go a long way in restricting the scope of the bank and prevent it from undertaking injudicious transactions.

The intention of the Government of India to make it compulsory on the part of banks to publish monthly statements of business amplifying the necessary particulars that are to be published is to be hailed as a sort of welcome measure. Their intention to secure the interests of the depositors is a noteworthy one. They have adopted the set form originally approved by the Cunliffe Committee. The C. B.

Enquiry Committee have given a new form[46] to be adopted which however differs from the uniform balance-sheet form approved by the League of Nations.

[46] FORM OF BALANCE SHEET

....Ltd.

....

Capital and Liabilities.	Rs. A. P.	Property and Assets.	Rs A. P.
Authorised Capital...Shares of Rs.......each		*Cash*	
		Cash in hand and at bankers...	
Issued Capital ... Shares of Rs. ... each		Deposits at call and Short notice	
Subscribed Capital ... Shares of Rs.......each		Bullion in hand	
Amount called up at Rs....per share (Less calls unpaid)...		*Investments*	
		Gilt-edged and Trustee securities	
Add (Forfeited shares......)		Debentures...	
Amt paid up		Other items	
Loan on mortgage or Mortgage Debenture bonds		Bills receivable per contra ...	
RESERVE		Loan and other advances ...	
(Details of separate funds, if any, may be given)		Cash credits and Demand Advances	
		Loans	
LIABILITIES		Bills discounted	
Current and savings Bank deposits		Sundry debtors and Debit Balances ...	
Fixed deposits		(*N.B.*—the following statement should be appended here)	
Debts due to Bank, Agents, etc., fully secured against securites, *per contra* ...		"These loans and advances are shown after deducting full provision for doubtful debts."	
Debts due to banks, Agents, etc. unsecured		If this has not been done any balance of doubtful debts not fully provided for should be shown in (3) below.	
Bills payable		Included in the above statement	
Sundry creditors		(1) Debts due by Directors " Officers of the Bank."	
Unclaimed dividends ...			
Acceptances *per contra* ...		(2) Other debts	
Bills for collection—Bills Receivable *per contra* ...		(3) Doubtful debts	
		Due from customers for acceptances *per contra* ...	
Profit and Loss			
Balance as per previous Balance Sheet		Land and Building ...	
Less Appropriation thereof ...		Less Depreciation ...	
Balance brought forward		Furniture and Fixtures ...	
Profit since last Balance Sheet		Other Assets ...	
		Profit and Loss ...	

[46] C. B. Enquiry Committee—Majority Report.

Audit.

Registered auditors have to be selected by banking companies for audit of their account. Auditors must be held responsible for omitting to state material facts in their reports and in the preservation of their actual accounts.

Inspection.

The Government ought to appoint *inspectors* for investigating the accounts of banking companies if one-fifth of the number of shareholders so request the Government to conduct an *investigation.*

Such other useful provisions as the holding of the annual general meeting not later than 3 months after the close of the year, the transfer of bank shares, the registration of transfer of shares, the registration of mortgage charges created by the bank with the Registrar of the Joint-Stock Companies and the voluntary liquidation of banks under the aegis of supervising Committees or the control department of the Reserve Bank have to be enacted in the *special Bank Act* of the country.

Banking control.

There is no use of bare laws being passed but an efficient machinery to secure their proper observance by the different banking institutions should be created by the Government.[47] The Government of India should have a separate department to inspect the banks or appoint officers of the Indian Audit Department to carry on an independent audit of the banking work, not merely to supplement the work of the auditors appointed by the shareholders but to make effective suggestions as regards the actual work that is done. The report of the surprise audit should be in duplicate and one of these

[47] Although industrial legislation was enacted in this country still the steps to enforce this legislation are not adequate even at the present day. From the report of Industries in Bengal one can understand how meagre the inspecting force was with the result that in 1923 only ⅓ of the factories were inspected more than once even in the course of the year. Except in Bombay adequate arrangements for proper inspection are not made. Indians are not generally admitted into this line and women inspectors of factories are very few. Not only are the factory laws not properly enforced but as there are very few prosecutions and very small fines on these offenders all those salutary precautions are not strictly enforced. Even in the case of co-operative societies the audit work is not efficiently done as there is not one auditor for every hundred co-operative societies in Bengal.

should be sent to the Registrar of the Joint-Stock Companies and the other should be sent to the Board of Directors.

The sole reason why reliance is placed on the Government Audit is this. The present knowledge of the auditors is very meagre and the majority of these possess no extensive knowledge of the banking machinery. Several of them wilfully and knowingly permit the managers to indulge in unsound finance thus imperilling the financial stability of the institution. The Government Audit will not be open to this grave defect. As the report is not thrown open to the public no damage to the credit of the bank can be inflicted by any suggestion the Government Auditor can make. It is for the Board of Directors to loyally adopt all their suggestions and bring about a better and scientific management of the banking institution than before. Such a compulsory outside audit would go a long way in standardising business methods, enforcing conformity to statutory and conventional requirements and giving strength and public confidence to banking in this country. To the English Bankers "unfettered with chains of restrictive legislation," any meddling of the state officials in the internal economy of the banking profession might appear as a violation of healthy freedom. As the Bullion Committee Report puts it "financial legislation is interference." *Prima facie* legislative interference is bad but the suggestions outlined here would not be practically objectionable. Compulsory legal regulations on the lines suggested in this chapter would not be either an impediment to efficiency or an excessive limitation tending to injure the freedom of the banker. Similar provision for legislation and efficient inspection of banking companies exists both in the Dominion of Canada and Denmark. Without bank inspectors free from and independent of political interference or any other machinery to enforce the rigid observance of banking laws there is no wisdom in enacting mere regulations.[48]

[48] See also the Report of the Commission of the American Financial Experts headed by Dr. E. W. Kemmerer on the state of banking in Poland—the necessity of inspecting the banks to ascertain their solvency and judge whether business is conducted according to regulations or not is clearly brought out. A Commissioner aided by any adequate staff of inspectors is to be in charge of this inspection work. The recent Banking Commission in Germany is contemplating measures to enforce greater liquidity of operations on the part of the Commercial Banks, to make specific statement of liabilities and to insist on a prompt publication of balance sheets.

The author is not unaware of the defects of mere formal and mechanical Government inspection. The public would also be led to imagine that by mere state inspection the banks are conducting sound business. It is true that the responsibility of the Government would become apparent if their inspecting staff fail to detect weaknesses and it is their bounden duty to permit no banks to continue in this state of business if they have detected any flaws. Mere bank inspection does not however tantamount to Government guarantee of deposits. In view of the special circumstances of the country the need for considerable measure of Government control over the banks is essential and must be recognised. Bank inspection must give good assistance, wise counsel and provide tactful control. This reform practically imposes financial burden and more administrative duties but if a good deal of headway is to be made against popular apathy these have to be shouldered. Public confidence in banks can result only out of the Government's intimate relationship, scrutiny and control over the bank.

Immigrant Banks.

The present-day treatment accorded to the immigrant banks is a very fair one. The Government of India wisely refrained from raising a Chinese Wall and refusing access to foreign institutions. This has led to the investing of foreign capital in our country. The exchange banks expressed their unwillingness to subject themselves to any banking laws which may be passed by the Government and they were unwilling to publish any monthly balance-sheet according to the proposed form.[49] The immigrant banks should secure a license from the Reserve Bank. One of the terms of the license which the Reserve Bank would issue should be that the Indian creditors of the Bank should be given prior claim on its Indian assets and should be allowed to share in the general assets if there is any shortage in the Indian assets. They should agree to conform to laws passed in India. They must present their byelaws, lists of shareholders, etc.

[49] Periodic returns of their Indian Business should be filed before the Reserve Bank in the printed standard form.

In justice it must be frankly admitted that they never transgress the established maxims of sound banking nor are they inadequately capitalised. Their capital is being employed here as well as in the country of their origin. It cannot be ascertained with any degree of accuracy nor is it safe to publish the ascertained amounts of capital they employ here and at home. So long as they keep adequate balance for their Indian deposits, that is deposits attracted in India, there is no reason why they should be subject to the statutory rules that may be enacted here.[50] Although they might not be made subject to this legislation still they can be forced to train Indian apprentices in the higher field of banking practice. The foreign banking corporations in Turkey are forced to employ Turks on a *fifty per cent.* proportion on their staff. Quite recently the Ionian Bank was threatened with stoppage of business for failure to carry out this provision of law within a stipulated date. The latest piece of information [51] about Nationalist Turkey's attitude towards foreign banks is that they have decided to use the calculating machines, etc., to dispense with labour. The Turkish Government evidently were anxious to retain employment of men of their own nationality in the banks rather than permit them to employ machines and dispense with the *labour of clerks.* It should also be stated in the license that they should have an Advisory Board in India to help them in their loaning and cash credit business.

Just as the private indigenous bankers are to be exempt from the application of these laws similarly these immigrant banks should be accorded quite a separate treatment from the Indian joint-stock banks but favouritism should not extend further.[52] Neither the refusal to grant the privilege of rediscounting nor the privilege of attracting deposits in India should form one of the restrictions maintained in the license.

Private bankers are exempt from legislation in every country. Even in the United States of America where there is stringent banking regulation there is not much interference with the business of the

50 They have to maintain a deposit with the Reserve Bank equivalent to the prescribed ratio which the scheduled banks have to deposit with the Reserve Banker. Their Indian assets have to be audited in the manner required by the Reserve Bank.

51 See the "Statesman," July 4, 1928.

52 Formerly the Indian Exchange Banks in London used to get deposits from the Secretary of State out of the London cash balances at very cheap rates of interest.

larger private bankers. Sec 160 of the New York banking law contains these restrictions levied on the smaller private banks.

The Reserve Bank should make arrangements for carrying out banking amalgamations for establishing branches of existing banks and co-operate with banks who might be experiencing financial difficulties.[53] The carrying out of Government inspection of banking offices and branches can be done by a department of the Reserve Bank.

Banking Statistics.

The statistical information available in India is quite inadequate to enable the country to deal with the different problems of bank extension, safety and legislation. They are published at different times in different blue-books generally at a too belated hour to be of any use to the serious student of banking problems. The statistics officer should be given statutory power to inaugurate a scheme of publicity on the lines cutlined already. Any other items of information which the banks are willing to publish can also be published. The erroneous idea that a rich country like the U.S.A. alone can afford to have great expenditure on statistics must be dispelled. A certain amount of overlapping, duplication and sheer waste may result in the endeavour to collect information. But publicity would have a decisive influence on the conservativeness of the banks. Banks would naturally hesitate to give any information which might encourage competition. But the nation as a whole cannot acquiesce in this decision. As banks control the economic destiny of the nation the banking laws should be so framed as to secure this wider end in view. The interests of the nation are closely bound up in the whole question of the reform of bank operations in the direction of greater publicity.

53 Amalgamation of the Foreign Exchange Banks with the Indian joint-stock banks may take place only after securing the necessary consent of the Finance Minister acting in consultation with the Reserve Bank. Even the opening of new branches of the Foreign Exchange Banks should be done after securing the sanction of the Reserve Bank which has to be actuated solely with the motive of securing proper geographical distribution of banking offices within the country.

Books for References.

1. The Memorandum on Commercial Banks. League of Nations publication.
2. The Bowley-Robertson Committee Report—" A Scheme for Economic Census of India."
3. B. R. Rau, "Elementary Banking."
4. B. R. Rau, "Written Evidence before the C. B. Enquiry Committee."
5. World Economic Survey, " The League of Nations, 1931, 1932, 1933, 1934, 1935."

Since the Chapter has been sent to the press the 1936 Companies Amendment Act has been passed. See Part XA 1936 Companies Act. See 277 F to 277 N deal with banking companies. A commentary on these provisions will be made in the author's forthcoming work "Foreign Banking Systems and their Lessons for India."

CHAPTER XXI

Recent Monetary Reform (1927-28).

Act IV of 1927—Significance of Fragmentary Reform—The new Currency Standard—The currency authority and deflation—Emergency currency—The sale of Treasury Bills—Their meaning—Their utility—Repayment—When was the policy adopted in India.—The object of the sale of Treasury Bills—Supposed Disadvantages—Justification of the sale of Treasury Bills—Limit to the sale of Treasury Bills—Remittance programme—Purchase of sterling in India—Several alternative methods of remittances—When was it taken up—Reasons for this change—The main advantage of this scheme—Disadvantages—Conclusion with reference to remittance programme—The dangers of external borrowing—The policy of the Government of India—Recent sterling loans—Conclusion as regards public borrowing—The defects of the existing regime—The silver situation—suggestions to improve the situation—The other recommendations of the Hilton-Young Commission.

Act IV of 1927.

The enacting of the ratio bill on the Statute Book as Act IV of 1927 and the Indian Legislative Assembly's refusing to consider the gold standard and the Reserve Bank Bill led to fragmentaryre form of the Indian monetary situation. As in the case of all attempts at fragmentary reform it has proved to be a blunder and instead of the drastic reforms outlined by the Hilton-Young Commission being carried out *in toto* the least important of the suggestions have been carried out and the more momentous ones have been allowed "to go hang." It has really ended in tinkering with the situation while real comprehensive monetary reconstruction has been postponed *sine die.*

Significance of the fragmentary Reform.

The inner details of the Hilton-Young Commission's proposed monetary reform have become thoroughly familiar to our people. The present situation brought about by stabilising the exchange at 1*s*.6*d*. gold value of the rupee has been described as the "hardening"

of the gold exchange standard prevailing in the country.[1] As this runs counter to the popular aspirations of the people the real significance of this fragmentary reform has to be studied. Although the present writer is not convinced of the suitability of the scientific gold exchange standard to this country, yet as the Indian Legislative Assembly gave the go-by to the Reserve Bank—working as the sole authority, managing credit as well as currency, several of the inherent defects of the currency system of pre-Hilton-Young enquiry period remain. A sincere attempt should be made by the currency authority to carry out several of the suggestions outlined herein so far as they are practicable and thus remedy someof the more glaring defects and give an assurance that manipulation of the reserves would not be undertaken, that seasonal expansion would not be delayed as soon as money becomes stringent and the bank Rate has attained 6%, that the gold securities would not be frittered away and that there would be no confusion between the fiscal and monetary objectives in the sale of exchange. Some of the minor indications considered essential to create the confidence in the Government management of the currency system are briefly alluded to.

The New Currency Standard.

The present currency system is substantially the same as that outlined by the Hilton-Young Commission except that unfortunately it has to be operated by the Government as the currency authority and the methods to enforce the gold bullion standard are conspicuous by their absence. There are no well-defined means for selling and buying bullion at the stated prices and in the absence of huge stocks of gold bullion in the hands of the Government or the Reserve Bank it clearly cannot be undertaken on a large scale. The Indian Currency Act of 1927 established the ratio of 1*s*. *d*. by enacting that Government would purchase gold at a price of Rs. 21-3-10 per tola of fine gold in the form of bars containing not less than *40 tolas* and would sell gold,[2] or at the option of Government, sterling, for immediate

[1] See the Economist, London, 1st February, 1928.

[2] Section 5 of the Act makes the provision regutating the sale of gold bars of the weight of 1,065 tolas at Rs. 21-11-6 psh

delivery in London at the same price after allowing for the normal cost of transport from Bombay to London. The Government's selling rate of sterling exchange was fixed at 1*s*. $5\frac{49}{32}$*d*. to discharge the above obligation.

The silver rupee though mainly intended to be a token coin is still the sole unit of account. The future of the silver rupee is still practically illogical and has the dangerous quality of unlimited legal tender privilege attached to it. Its interconvertibility into gold or gold exchange is also legally secured though it is not effectively carried out. After the assumption of the sterling standard mechanism it has been found necessary to continue the policy of dethroning the silver rupee. An agreement has been entered into to sell off surplus stock. As it has been referred to elsewhere no mention need be made *in this chapter*.

Confident of the facts that India would have a favourable balance of trade and that the world would stand in need of India's raw material during the period of industrial regeneration and as India is repurchasing its own securities and converting external into internal debt the new exchange ratio of 1*s*. 6*d*. for the silver rupee was fixed. The plus valuation on the pre-war ratio of 1*s*. 6*d*. for the silver rupee was fixed almost in deliberate violation of the experience of an overwhelming majority of people who have never noticed the persistence of this ratio for such a long period as to be claimed as the "*de facto ratio.*"

The excrescent currency, *viz.*, the gold sovereign has been demonetised and in its place this new obligation of buying and selling gold on sterling has been inserted. Though, in theory, this provision differentiates it from the gold-exchange standard system which makes the gold exchange alone available for (practical) external purposes yet in actual practice of the present standard the free and unrestricted selling of gold did not take place on any appreciable scale. In 1927-28 the Government received sovereigns to the value of Rs. 5,034. In its anxiety to economise the use of gold the currency authority might actually tend to make this new standard hardly different from the gold exchange standard system. The provision to buy and sell gold can be rendered innocuous and if the gold bullion standard as operated by the currency authority does not, after all, assume the conversion of local or internal currency into gold without

the intervention of external currency it must be considered a decided failure.

The Currency Authority and Deflation.

Coming to the course of actual currency operations during these years the Government is still the currency authority during these years. No clear-cut principle of deflation or inflation of currency seems to have been pursued by the currency authority. While holding its own cherished opinion that the Indian money market is always intolerant of *deflation* it pursues deflationary tactics evidently with the motive of supporting the exchange ratio for the rupee. Neither are the signs of *redundancy of currency* absolutely understood aright. Such features as the slackening of the grip of seasonal stringency in recent years, the return of rupees from circulation during the slack season, the small absorption of rupees in the busy season, the heavy cash balances of the Imperial Bank in the slack season and the release of currency before the actual purchase of sterling are not weighed against the total demand for currency needed by the growing population and their increasing trade. Both the positive and negative proofs of redundancy of currency ought to be interpreted aright before the deflationary move is embarked upon by the currency authority. There ought to be a right balancing of all factors, home currency demand, supply of the same and world level of prices prevailing at any one particular time. The safety of currency supply is not now assured by the Government acting as the currency authority. Though it is not drastic deflation that is being pursued by the currency authority the impression is created that an unfair use is being made in this direction. It has been stated plainly that were the Government to continue to act as the currency authority it would work better for purposes of contraction and any automatic expansion of currency, even at stipulated rates so as to assure the businessman of the safety of currency supply can be delayed by it.

Emergency Currency.

So far as the supplying of seasonal emergency currency is considered the Government of India failed to provide the money market with the additional loan that could be secured by the Imperial Bank.

when the bank rate rose to 6% in February, 1927. The delaying of the seasonal expansion arbitrarily without paying heed to the hitherto enacted regulations shows that the Government of India have no faith in providing seasonal requirements or its anxiety to let no factor distrust the rate of exchange might have overruled all other considerations in this matter and that interests of trade and business are secondary to this prime consideration—are very often the conclusions that are drawn by this unjustifiable delay in supplying emergency currency and forcing the bank rate to rise to 7% before the emergency currency is released. Of course the psychological assurance that emergency currency would be available has its own influence in raising the bank rate. It is not denied. Again the impropriety of curing the high rates of interest for short-term periods by seasonal expansion of currency is undoubtedly recognised by the writer. As Prof. E. Cannan has clearly demonstrated that the demand even for money would be influenced by the incoming advent of additional funds the forecasting of seasonal supplies at levels of bank rate would be futile. But all my academic experience forces me to condemn the increasing of the stringency of money and subjecting trade to high rates which are preventable by timely action. It has already been shown that the Central Bank of Issue can by an increase of its note-issue and deposits satisfy the seasonal demands of emergency currency.

The Treasury Bills.

A new feature inaugurated by the currency authority in 1927-28 and continued up till the present moment (March, 1934) was the policy with reference to the sale of Treasury Bills. The Treasury Bill system is of English origin.[3] It is purely meant to obviate the direct depend-

[3] In the pre-war days the Bank of England floated Treasury Bills when the receipts of taxation were insufficient to cover Government expenditure. They were sold at convenient intervals to purchasers by tender. On April 14, 1915 the Bank of England issued several classes of Treasury Bills with maturity up to *12 months* after the date of issue. It was given up on 3rd February, 1917, and continued again from March, 1917 to June 1, 1917. Treasury Bills were again issued in 1919 and the English joint-stock banks generally hold the Treasury Bills in their portfolio. When the floating debt represented by the Treasury Bills was founded the Banks took a part of the funded loan in lieu of the Treasury Bills.

ence on the Central Bank for advances to the Government. Denmark also recently adopted the system.[4]

Their meaning.

The classification of the indebtedness of the Government of India into funded and unfunded debt,[5] external and internal and productive and unproductive has become well-understood by this time. Ways and Means Treasury Bills fall under the category of floating or unfunded debit and are meant to be repaid during the course of 3, 6 or 12 months. Treasury bills, as one critic aptly describes them, are "the last refuge of the drowning minister to keep up his head." Though this description is an exaggeration, it does not however fail to point out the fact that the Finance Minister lacking ready resources anticipates future revenue and floats these evidences of short-term indebtedness. This is the real origin of the Ways and Means Treasury bills. But Treasury Bills may be a legacy of war. It may be the policy of the Government to keep a portion of the permanent public debt in the form of Treasury Bills.

Their utility.

Like the commercial bills the Treasury Bills afford scope for the banker to employ his funds remuneratively and safely at the same time. Treasury Bills can be rediscounted at the hands of the Central Bank during times of emergency. The ordinary banks and the finance houses consider these Treasury Bills as a safety valve for if greater funds are needed for commercial finance they can reduce the advances to the Government in this respect and grant more funds to commerce. In the slack season when commercial demand for banking accommodation falls off the holding of the Treasury Bills can be increased for they will always

[4] See D. T. Jack, "The Restoration of European Currencies," p. 75 (foot note).

[5] The other contingents of the unfunded debt are the P. O. Cash Certificates, Posta Savings Bank deposits and other miscellaneous obligations such as the Provident Funds etc., etc., etc.

be afloat on the money market. They can thus act as an invaluable aid to banks.

Secondly, it enables the Government to control the money market by this new and regular feature and inflation and deflation can be pursued through this recognised channel. If it wants to inflate this floating debt would increase and as it is disbursed by the Government the bank would get back the funds through the customer's balances and so this vicious circle of inflation can go on unchecked to a certain limit. Inflation used as a method of war finance was only an extended use of this well-known mechanism. If deflation has to be pursued the amount of bills running would diminish. By offering smaller amounts than are running off the Government can diminish the total number of bills in the market.

Thirdly, the process helps in creating a discount market. In the absence of an " open market " where trade bills cannot be discounted the gap can be filled up by substituting Treasury Bills to a great extent. The liquidity of the resources is the prime criterion of the bank in holding any instrument in its portfolio. The unquestioned standing of the Treasury Bill and the possibility of readily converting it into legal tender money at the hands of the Central Bank makes it an ideal investment for the banker and private financial houses who desire to convert their temporary cash into a desirable and liquid investment.[6]

Lastly, the rate at which the Treasury Bills are discounted by the banks can be used as a long-distance signal for the raising of the bank rate. A great disparity between the two rates means that the bank rate is not effective and the holding of bills is no longer remunerative. Foreign bill-holders may remove their resources from this field of lesser utility to a field of more promising return. This would mean the outflow of gold from the country to check which the Central Bank will ultimately intervene and this is done by raising

6 The ideal employment of commercial bank credit is in financing the movement of goods and in financing short self-liquidating transactions. The holding of bonds as investments, collateral loans against securities, and the holding of instalment finance paper are glaring examples illustrating how principles of bank liquidity are violated by the modern commercial banks. These are relied upon as good assets for they can be shifted to other banks when cash is needed.

the bank rate. Hence it can be described as the long-distance signal for the Central Bank's rate. These are the theoretical advantages that can be reaped by pursuing a scientific policy with reference to the sale of the Ways and Means Treasury Bills in the money market. It must be recognised that the United Kingdom has been the first country to point out the working of this intricate mechanism in the complex sphere of the money market.[7]

Repayment.

The Ways and Means Treasury Bills are always to be repaid on maturity. Though certain impecunious Governments have sometimes converted them into permanent debit instead of repaying them, the best policy is to float a fresh batch of Treasury Bills and repay them on maturity. Of course constant renewal of floating debt has a disastrous effect on the economic life of the country. But in days of straitened resources this hand-to-mouth policy may have some justification.

When was this policy taken up in India ?

It was first adopted by the Government of India during the period of the recent war.[8] They commenced the systematic sale of the Treasury Bills in 1918 to enable them to finance the requirements

7 See Walter Leaf, " Banking," pp. 205 208. For a historical treatment of the use of the Treasury Bills in the London Money Market, see W. F. Spalding, " Dictionary of World's Currencies and Foreign Exchanges," pp. 188 and 189.

8 The Government had to meet a very large amount of expenditure by issuing short-term debt. It continued outstanding till 1919 and when that increased figure had to be paid new Treasury Bills were floated at a higher rate. With deficit balances and a large amount of short-term debt floating which at one time amounted to 50 crores of rupees, the Government of India was forced to float loans in London and India to pay their way and pay off some portion of the floating debt. By April, 1924, the Government succeeded in paying off the large portion of the floating debt which consisted solely of Treasury Bills and Ways and Means Advances. Treasury Bills held in the P. C. Reserve were paid off and P. C. Notes cancelled to that extent. Good monsoons also helped the Government to succeed in raising the rate, *i.e.*, the exchange value of the rupee. From August, 1923, the Government policy was to supply additional currency to the extent of seasonal requirements (see Sir Basil Blackett's Evidence before the Hilton-Young Commission, Vol. IV, p. 14 and the following).

of the Imperial Government of the United Kingdom. Though there was no systematic adherence to this practice it was reintroduced in August, 1927, as a permanent feature of the financial policy of the Government of India. Three months, and six months' Treasury Bills, the lowest denomination of which is Rs. 5,000 are issued at a discount which sometimes comes up to a high rate. The practice has been continued since then and taking up the recent announcement on March 27, 1928, regarding Treasury Bills we find that "tender for six months' bills at Rs. 97-9-0 and above aggregating Rs. 52,50,000 were received and accepted in full. Tender for these bills at Rs. 98-10-0 aggregating Rs. 12,25,000 were also received and accepted. The average rate of accepted tenders for six months is Rs. 97-9-4. From 21st to 26th March Intermediates were sold of which Rs. 6,25,000 were for six months and Rs. 3,75,000 were for three months. Intermediate bills will be issued from March 28 to April 2, at the following rate—Rs. 97-10-3 for six months' bills and Rs. 98-10-3 for three months' bills. Tenders for one crore of six months' bills and Rs. 75,00,000 of three months' bills will be received on Tuesday, April 3. Successful tenderers should make the payment of the amount accepted on Thursday, April 5. The average of interest of accepted tenders for three and six months' bills is again unaltered at 5½ and 5%." This rate would always depend on the money market rate for short-term loans when the tender is being made.

The Object of the Sale.

The first object of the present-day sale of the Indian Treasury Bills is to regulate the Government balances evenly in India all the year round. This necessitates also lower balances.[9] The indirect advantages that are claimed are very many. It would tend to stabilise the value of the Government securities by preventing speculation in their value in the slack season with the help of bank money and the bank would be too eager and willing to lend money for the occasion.

[9] See Mr. H. Dunning's Oral Evidence before the Hilton-Young Commission, Vol. V, p. 74.

During the slack season "money becomes a drug in the market" and if it is lent to the speculators the Government securities would be subject to their influence. The banks themselves are great holders of Government securities and the stabilisation of their value is a great advantage to them.

Another indirect advantage would be the stabilisation of exchange that can be secured out of a judicious sale of these Treasury Bills which can absorb the surplus funds in the money market. These funds would be deposited in the hands of the Reserve Bank and would be available to the market through this institution. Even if stringency of funds in the money market were to result there would be release of funds through the purchase of sterling.

Secondly, a more stable bank rate all round the year would be realised if the bank balances are equalised during all seasons, *viz.*, the busy as well as the slack seasons. It would undoubtedly help the Reserve Bank to obtain higher profits than before but this is purely an advantage to a particular institution.

Thirdly, it would reduce the necessity on the part of the Government to maintain huge cash balances for carrying on their daily round of duties. Now that two other valuable sources of finance exist, namely, the floating of Treasury Bills and the ways and means advances from the Reserve Bank of India, the third and antiquated one of keeping large cash balances can be dispensed with. The reduction of heavy cash balances has been the objective of all monetary reformers of our country.

Finally, the great national advantage which the smooth functioning of the Treasury Bill system would indicate is the help which it would furnish in fixing the bank rate of the Reserve Bank. If the rate for the Treasury Bills is very low it is clear that the bank rate is not effective and the hidden hand of the Reserve Bank would soon have to be employed if gold leaves the country and exchange becomes unfavourable. Now that the Central Bank has been created it clearly follows that this can be considered as a possible future advantage. At the present stage it may contribute something towards the perfection of the discount market and if the Reserve Bank rediscounts these Treasury Bills for some period of their time before maturity some sort of preliminary education can thus be imparted to the bankers who can

rediscount commercial as well as Treasury Bills at the hands of the Reserve Bank.

Supposed disadvantages.

But unfortunately the banks which are the chief sufferers in the matter have already set up a protest and have determined to pursue a *non-possumus* attitude in this matter. Since Sir P. Sethna uttered a feeble protest against the sale of these Treasury Bills the dissentient critics are becoming more loud in protest. Some have adopted a blustering tone and in addition to non-co-operating in this matter the supposed disadvantages are descanted upon. Some of the prophesied evils are the crippling of the gilt-edged market and the eradicating of the Indian joint-stock banks altogether from the money market. Lastly their unsuitability to this country where the banks are struggling hard to attract deposits is commented upon. It is pointed out openly in a tone of derision that the Government are forced to pay " fantastic rates " of interest for their short-term indebtedness in spite of the much vaunted improvement in the credit standing of the Government [10] It is stated " that the credit of the Government is far lower than that of the credit of the banking institutions of the country." But these conditions have changed and the Treasury Bill seems to have become an integral feature of the money market.

Justification of the sale of Treasury Bills.

It behoves us to examine these statements before any opinion can be expressed on the desirability of their sale. The first reason why treasury bills are sold is to secure money for short periods when there is a big gap between revenue and expenditure.[11] If the ways and means advances from the Reserve Bank can secure the

[10] See the statement of the Bengal National Chamber of Commerce, Vol. II, p. 497; C. B. Enquiry Committee. The answers of Bombay Share and Stock Brokers' Associations—Bombay Committee Evidence, Vol. II, p. 546.

[11] The land revenue of the Government generally flows in during January and if heavy commitments are to be met in the months of September and October when cash balances are insufficient resort to this method is justifiable on the part of the Government.

needed money there would be no resort to the ways and means Treasury Bills, for money locked up here would lessen the available funds for commerce and trade. Hence the bounden duty of the Government is to see that it does not encroach on the available commercial funds of the money market. If the balances of the Reserve Bank are depleted the method of borrowing in the market is resorted to. But so far as the Reserve Bank is concerned there is always provision to enable it to continue its business in spite of reduced cash reserves below the statutory limit. The raising of the rate protects the cash situation and increases the cash position of the bank. Again when speculation is being conducted with the help of funds in the money market the Central Bank always raises the rate and protects the situation. If it fails to achieve this by raising the Bank rate the surplus funds are withdrawn by borrowing on the Government securities. Thus it is always a recognised policy on the part of the centralised banking system to protect the interests of the people from the harm resulting out of unbridled speculation aided more or less by an easy monetary situation. If the Government of India is attempting to do this in the absence of a Central Bank there is no reason to feel aggrieved at the situation.

If the other advantages can also be realised the sale of the Ways and Means Treasury Bills would have to be welcomed. If it constitutes anything towards the perfection of the discount market and rediscounting becomes an acknowledged fact this measure must be hailed as a welcome one. Of course, the Government is not unaware of the difficulties of this policy. These would have to be discontinued as soon as a big loan programme such as that of the 1928-29 financial year would be launched and permission should be given to the holders of Treasury Bills to subscribe to the loan. If more satisfactory conditions are meted out to the subscribers than in 1927 Rupee Loan there is no reason why such loan should fail.[42]

[42] Since these lines were written the 1928-29 Rupee Loan was floated and in spite of its being the biggest internal loan floated by the Government it proved a distinct success. The 1929-30 Rupee Loan has proved a failure. A Loan Council has to be created in order to regulate external borrowing in the International Investment market. Greater opportunity to Indian subscribers is an essential improvement that isreally neglected at present. Since the Reserve Bank has been started these conditions have greatly improved.

In the interim period when banks feel the shortage of deposits they would have to pursue other measures for increasing the volume of deposits and they cannot enforce the Government to desist from controlling the market by means of this method. The most successful methods of increasing bank deposits have already been stated in an earlier chapter.[13] If the sole grievance of the banks is that the Government is absorbing all available funds which would have been deposited in their hands the banks would have to increase their vigilance in the matter of securing deposits and they can also insist on re-discounting facilities being extended to them by the Reserve Bank. The Government, the Reserve Bank, and the Indian joint-stock banks can co-operate with each other and thus smooth down the peaks and troughs of credit occasioned by seasonal demands for money and the Government's financial policy.

It is recognised that in the slack season the Indian joint-stock banks are too willing to lend funds on jute shares at a nominal rate. Touting for business would be unnecessary and unusual balances would not act as a drug on the bankers and speculation in the value of the Government shares in the slack season need not be resorted to for obtaining decent profits. The Treasury Bills would render these somewhat questionable uses unnecessary. They would furnish an element of strength, liquidity and profit to the bankers and other private financial bodies. After the perfection of the discount market and the familiarising of the banks of the rediscounting feature the employment of the Treasury Bills should be confined to their legitimate function, namely, the securing of short-term money to tide over temporary deficiency and enable the Government also to give proper place to these Treasury Bills in the public debt programme they follow.[14]

A Modest Limit.

In other countries there is a limit set to the Treasury Bills or short-term obligations which the State can issue. In an undeveloped money market as ours the financial aid which the Government can

13 See the earlier chapter entitled "Banking Reserve."

14 The Budget should always make provision for the outstanding Treasury Bills in the hands of the public at the end of the financial year and in no case should this figure be exceeded.

secure from it should be limited.[15] If the Government can float any amount of these Treasury Bills there would be serious consequences to the credit position in the country. The charters of some Central Banks contain specific provision restricting the amount of Treasury Bills which can be discounted for their respective Governments. A similar provision was not enacted in the charter of the Reserve Bank of this country. It should also be the accepted policy of the Government to secure this accommodation only at a rate which is consonant with the rate which banks pay for deposits of a like-period. As Sir Hilton-Young says, " the Treasury, while borrowing money for short-terms at the lowest possible rate, should learn from its mercantile rivals in the loans market. It should compete for loans with commercial borrowers on an equal footing making use of all the refinements and economies which they have invented to facilitate their borrowings and in particular of the bill."[16]

Remittance programme.

The remittance operations, though recognised as properly belonging to banks, are still in the hands of the currency authority. The Government being the currency authority, can secure any objective of its own through the influence of its remittance operations on the money market. If the monetary ideal of the currency authority is to economise the use of gold the free flow of gold into the country can be checked by purchasing sterling beyond the actual requirements of the Government. It should not however be confused with the currency ideal that has to be worked out in the country. More gold resources are essential for working the gold bullion standard in spite of any precautions which may be taken to protect it during the formative or the testing periods of its early years of existence. When America was parting with its stock of gold and co-operating with all countries who were coming round to the gold standard the securing of gold as done in March, 1927, so far as the gold standard reserve was considered, should be carried further and as the real gold

15 At one time the Government floated Treasury Bills to the extent of 55 crores February, 1931).

16 See the System of National Finance, p. 241.

metallic backing against notes in the P.C.R. is not sufficiently high no opportunity to strengthen the gold stock should be lost.

The inauguration of the tender system in the purchase of sterling is another important factor or innovation brought about during the course of the financial year 1927-28.

Purchase of Sterling in India.

The new system of remittance operations perfected by the Government of India during the course of the last decade is not thoroughly understood by the public. It is not only essential that its advantages and disadvantages should be understood but the far-reaching consequences underlying this method should be realised by all students of Indian financial problem.

The object of remittance.

The Government of India is a subordinate body subject to the sovereignty of the British Parliament. While it realises its revenue in silver in India it has to meet certain obligations to the extent of roughly £35 to £40 millions annually in London. This necessity forces the Government of India to enter the exchange market for converting its rupee resources into sterling resources at as advantageous a rate as is possible for it to secure.

Several alternative methods.

Although theoretically speaking this can be done by several methods the most suitable and advantageous ones have to be resorted to in preference to others. Firstly, the sale of bills in the London Money Market on the Indian Treasury against the receipt of sterling in London can be done to suit the Secretary of State's requirements. This was the old time-honoured but recently discarded system of the sale of Council Bills in London. Secondly, there is the purchase of

17 For a history of the Council Bill sales see Mr. H. Waterfield's Memorandum—Appendix to the Fowler Committee's Report, p. 24; also Mr. Neumarch's Memorandum on the same subject—Appendices, Vol. I, No. 8, p. 20. See also Mr. (now Sir) Kisch's Memorandum on Remittances which consists of the *1915 rules* with reference to this sale of Council Bills to the Hilton-Young Commission, Vol. II, pp. 484-89.

sterling from banks and private financial houses willing to sell their sterling resources in London for rupees offered to them in India. This is the present method which has displaced the above one. Thirdly, there is the buying of gold bullion and exporting it from this country to London. The exporting of silver cannot be resorted to as it would be sending silver from the better market to a less advantageous one. The Government would be the loser by this method. Even in the case of gold shipment the loss of interest, freight and insurance charges would amount to much. Fourthly, the Government can buy sterling bills drawn on London from reliable *mercantile houses* and send them to the Secretary of State for collection. This method was actually employed for a while in 1877 but was afterwards given up. Fifthly, advances can be made to merchants in India for purchase of goods consigned to the United Kingdom and repayable in England to the Secretary of State to whom the goods are hypothecated. The bills of lading of cargoes can be taken as security and thus remittance can be effected by this method. But inasmuch as their credit would not be of a high standing this method cannot be safely resorted to. It was actually employed to a limited extent by the East India Company and given up as "introducing a vicious system of credit and interfering with the ordinary course of trade." Lastly the Secretary of State can purchase the proceeds of loans floated by the *quasi-public* bodies in London and release its equivalent in rupees in India. This method is not always available but it is free from all defects.

Of these different methods each with its own limitations method two is the present accepted one of making remittances to London. The Reserve Bank would enter the money market and invite tenders on Wednesday at Bombay, Calcutta, Karachi and Madras. Purchases in the market can be made for the purpose of Intermediates on days when tenders are not received. Since these lines have been written (3rd edition) the Government of India used to pursue the policy of secret purchase in the slack season and invite tenders in the busy season alone.

When was it taken up ?

In the year 1923 the sale of Intermediate Councils was given up and sterling was purchased through the Imperial Bank from the

Exchange Bankers and other recognised financial firms as a supplementary measure to the weekly sale of Council drafts. The Imperial Bank was given the minimum buying limit by the Controller of Currency both of rate and quantity but it was also altered during the course of the same day. Although large purchases were made under this method the question of inviting tenders to secure the best rates was not taken up at any time. Neither the extent of purchases nor the rate at which the purchases were made, were published by the Government of India and these were freely left to the discretion of the Government of India.

The old system of the sale of Council Bills was not given up even in the official year 1924-25. Weekly sale of Council Bills was resumed only when there was a steady demand for rupees. But during the official year 1924-25 the sale of Councils did not amount to much. Even during this period much publicity was not thrown on these operations. It was only at the end of the month that the public could know the amount of purchases made by the Government in the money market. The Bombay Chamber of Commerce protested against this "lack of knowledge regarding purchase of sterling and suggested that the weekly return of purchases should be published."

During the course of the official year 1925-26 no sale of Council Bills took place. It has been completely superseded by the method of purchase of sterling. The following table with reference to remittances makes this point clear :—

Official year.		Sale of Councils in London.	Purchase of sterling in India.	Purchases of Secy. of State of loan proceeds of public bodies raised in London.
		£	£	£
1922-23	...	2,520,026	70,000	2,126,210
1923-24	...	8,738,705	13,100,000	1,302,950
1924-25	...	7,579,162	33,191,000	700,000
1925-26	...	(9 months) Nil	37,566,500	Nil.

The respective advantages of competitive tender and private purchase of sterling through the Imperial Bank were discussed before the Hilton-Young Commission but the advantages or disadvantages of this procedure as against the old one of sale of Councils were not

paid heed to. The Commission recommended the purchase of sterling in India by competitive public tender and the publication of weekly return of remittances.[18] This is now followed in actual practice and would doubtless be changed as soon as the Central Bank is created for this country. The remittance business of the Government would be done through the Central Bank in much the same way as it would conduct the other banking business of the Government.

Reasons for the Change.

Though Mr. Charles Nicoll and the Right Hon'ble Montagu Norman —the Governor of the Bank of England, opine that "a sentimental influence brought about tendering in India instead of London" there were weighty reasons for pursuing this change. It was to take advantage of a " firm or rising exchange" that this new method of sending remittance from this country has been devised. It was also recast to check rapid appreciation of the rupee or any undesirable up-rush of exchange so that sterling exchange was bought on an abundant scale. In October, 1924, it was decided to prevent exchange from rising above 1*s*. 6*d*. by the free offering of rupees according to this method. This method was devised by Sir Basil Blackett and the Government of India had to adopt it as an advisable one in the interests of India and as an improvement on the existing method of sale of Council Bills.

The main advantages of the scheme.

In days of fluctuating exchange it enables the Government of India to control the exchange market and with the full benefit of the knowledge of local circumstances influencing the course of exchange,

18 From April. 1927, the Government of India have been making weekly purchases of its sterling requirements by tender. Provision for Intermediate remittances is also made and the rate fixed by the Controller of Currency for the Intermediate T. T.'s is known as " tap rate." If the rate is not liked by the sellers of T. T. the tap rate would be practically inoperative and whether any purchases according to the tap rate will be made can be foreseen by the number of applications made on tender day. This indicates the possibilities of intermediate purchases.

the Finance Member can do something to impart tolerable stability to the fluctuating exchange and thus confer a boon on trade and the country.

Exchange can roughly be pegged at the selected rate at which rupees can be released and thus the object of stabilising exchange at a particular rate can be easily obtained by purchasing sterling for unlimited amount at the upper gold point of the selected rate. In the days of firm or rising exchange it can be employed to assist the further rise altogether. Just as the unlimited sale of Councils at 1*s*. 4¼*d*. prevented the free flow of gold into the country, the release of rupees at 1/32*d*. lower rate than the upper gold point of the rupee would prevent the free flow of gold into the country. If the Government is prepared to buy sterling over and above the requirements of the Secretary of State the exchange can be artificially pegged at this upper gold point of the rupee rate selected. This they can do safely so long as they can increase the British or Indian Government securities in the P. C. Reserve and issue P. C. notes against the fiduciary cover which can amount to half of the total reserve. The P. C. Amendment Act, February, 1925, has conferred this privilege and so long as there is this safety valve there need be no apprehension that by this new method they would fail to peg exchange at the upper gold point of the rupee rate. *Ad hoc* securities were recently created by the Government of India and paper currency inflated against them, so that further rise in exchange even by 1/32*d*. would not be brought about. Leaving aside the undesirability of such expansion by questionable methods this prevents the free flow of gold ; but the stability of exchange at the desired point which is the sole objective and absolute obligation of the Government would be obtained. Now that the Reserve Bank is endowed with the privilege of issuing notes it can purchase sterling with its notes.

In days of weakening exchange this method would not be of any utility. The old policy of selling Reverse Councils at the lower gold point of the rupee has to be resorted to. So long as the Government's Reserve is sufficient and kept at a highly liquid state for this purpose the selected rate can be made operative Gold or Gold Exchange can be released without limit at the lower gold point of the rupee. As the Reserve Bank has been created it is the duty of the Reserve Bank to varify credit and raise the exchange rate to the par point,

The old policy of selling Peverse Councils by the Government would have to be given up.

Under the old method of sale of Council Bills heavy cash balances could be kept by the policy of unlimited sale of council drafts over and above the Home Charges. Under this new method remittance can be made by the Government to meet the actual requirements and thus render unnecessary the piling up of huge cash balances in the Home Treasury. The sterling treasury bills can be floated by the Secretary of State in London if this remittance programme fails to provide him with adequate resources. It is no doubt expensive and this penalty should be incurred only as the last-go. There is thus total emancipation from the Secretary of State's control in the matter of remittance programme and some degree of monetary independence has been conferred on the Government of India. By unlimited sales of Council Drafts over and above the requirements of the Home Charges on the specious plea of satisfying trade requirements he used to transfer cash balances from this country or a portion of the P.C. Reserve By a judicious use of the new method this unjust transfer need no longer be tolerated and the interference of the Secretary of State in the matter of remittance is rendered as remote as possible.

Finally this method is evidently suitable and simple and the Exchange Banks need not depend on rediscounting their bills in London but promptly sell their sterling balances to the Government of India and thus replenish their rupee resources in this country.

Disadvantages.

. This method is not however free from defects altogether. Firstly, the upper gold point may not be reached at all under this method if rupees are released at 1/32*d*. lower rate than the upper gold point of the rupee. This means that free flow of gold can be diverted and impeded thus checking or restricting the automatic action of gold entering the currency system and rupees or notes being issued against that stock of gold. The price can be so arranged as to check the flow of gold. It is not here assumed that the gold would enter the Indian currency media or become a part of the currency of India.

Secondly, it is possible that the Government might not

follow the lead of the market but actually set the pace themselves. It is too closely interwoven with the currency policy and absolutely dependent on the Indian money market.

Thirdly, unless the purchase of sterling is definitely limited to actual or prospective requirements the free flow of gold into the country would be stopped. The magnitude of the purchase can be so arranged as to prevent the flow of gold into India. Enormous purchases can be made to cover (1) the amount necessary for the Secretary of State's expenses, (2) the further amounts as can be spared in a prosperous season towards the reduction or avoidance of debt in England and (3) the requirements of trade. But if great funds are remitted to the Home Treasury it would be locking up Indian funds in London. With the right or improper use of the funds we are not concerned here.

Fourthly, the public tender system at different places means delay involving the collecting of different demands at one centre. Although the time element can be overcome during these days of electric telegraph, foreign centres dealing with India would be at a disadvantage under the tender system in India. A large number of American people enter into jute contracts and these people would find it difficult to get along with this tender system. London being the world's centre, application by foreign countries for Councils could be easily made in London. Under the present system they generally send their requirements at least one day earlier to their agents in India. There is a big rupee market in London. It is being ignored by means of this new method and hence the best price for the rupee may not be obtained if this market in London is ignored.

The financial transactions of the Government are being subjected to controversy and criticism on account of this method of remittance. The purchase of sterling to the extent of £1 and ½ million on account of the P.C. Department on 14th January, 1928, has been criticised freely. The non-remittance uses made out of this method are likely to be contested strongly by the Indian public.

Finally, under this system rupees are released in India by the Government immediately before sterling is placed in the hands of the Secretary of State in London. Unless the credit standing of the parties is of a very high order such a thing cannot be done. The keeping of a Government list means drawing an unfair and invidious

distinction which would be resented by the people not favoured according to this discrimination. Although in actual practice no loss was sustained by such a procedure yet it is not so safe as the sale of Councils which meant the obtaining of sterling in London before the parting of equivalent amount of rupees in India.

Conclusion with reference to Remittance programme.

Although on the whole the system has given tolerable satisfaction to trade no time should be lost in starting a Central Bank and handing over this remittance programme to the Central Bank which would pay due heed to the needs of the market while remitting funds to the Secretary of State on behalf of the Government of India. The Central Bank should accept unlimited amount of gold in India at par and issue bank currency at the upper gold point against it and release unlimited quantity of gold at the lower gold point of the internal currency unit offered to it in India. Its acknowledged object should be to check fluctuations in exchange automatically by the free inflow and outflow of gold. Governmental interference in the management of remittances should not be tolerated in any manner. It is bound at certain times to be as iniquitous as interference in the management of currency.

External borrowing programme.

Public borrowing has become a most vital part of the system of public finance of almost all important states. While borrowing from private internal investors is advocated freely there is much condemnation of the policy of the Government's contracting external loans abroad. It is not recognised that even an internal loan might become a direct real burden as it transfers wealth from one section of society to another and increases the inequalities of incomes.[10] But it has the merit of retaining the wealth in the country itself. The repayment of external debt means the transferring of wealth from the borrowing country to the lending one, the exact reverse of what took place when the external loan was contracted. In spite of this chief

[10] See Adams, "Public Debts," p. 40, *et seq.* See Dr. Hugh Dalton, "Public Finance," pp. 191-192.

disadvantage external borrowing must be resorted to when the country's internal capital resources have become well-nigh exhausted or, if it is a capital-poor country with little or no resources, to develop the natural endowments which Providence has conferred on the country. Again a foreign loan removes undue pressure from domestic industries and does not influence adversely domestic prices.[20] But excessive foreign borrowing not only tends to bring exchange difficulties but may however end in undesirable entanglements specially if the Government fails to repay or repudiate the loans of [21] the wealthy external capitalists. It may lead to invasion and ultimate colonisation of the external capitalists in the territory of the borrowing country. Like Britain's occupation of Egypt many of the American republics might have been under the occupation of the European Governments but for the successful intervention of the U.S.A. under the influence of the famous Monroe Doctrine.[22] Inter-Governmental borrowing is less dangerous and would also lead to delicate international questions which end ultimately in disputes and wars when the debtor country does not promptly liquidate the loan.

The policy of the Government of India.

Although it is on these grounds [23] that independent Governments think twice before tapping the foreign capital resources, the subordinate Government of India borrows freely in the L. M. Market. Both sterling loans and sterling treasury bills are frequently contracted after securing parliamentary sanction which is unnecessary in the case of the Rupee Loans of the Government of India. But neither the Parliamentary authorities nor the Government advisors in London seem to pay due heed to the well-known principles of public borrowing and some of the recent sterling loans were floated in direct contravention of these established tenets. It is fairly clear that such a subordinate body

20 See Alexander Hamilton, Works (H. C. Lodge), Vol. II.

21 The only way the States can now hope to practically repudiate loans is by the pursuing of a currency policy detrimental to the interests of creditors.

22 See International Conciliation Pamphlet, No. 280, May 1933.

23 For a further discussion see my article "External borrowing for India," The Hindustan Review, June, 1929.

as our Government need not feel any embarrassment in borrowing from the politically superior or overlord country.

Flouting public opinion.

But though any danger need not arise out of this external borrowing any violation of the established tenets of public finance would injure the credit standing and the integrity of the Government of India. The gilt-edged securities would fail to play their normal part or the role of a useful adjunct in the Indian money market. It is not only essential that resort should be had to the external market as the *last alternative* but the right kind of fiscal policy had to be pursued in the contracting of loans. A contracting of long-term loan to tide over temporary current treasury requirements or seasonal expansion of currency is evidently unjustifiable. Nor should there be very great dependence on sterling treasury bills for financing permanent needs of either productive or unproductive expenditure. Treasury bills are unfunded or floating debts of the Treasury rather than permanent debts of the Government. They should always be paid out of the next incoming revenues. Special care should always be taken to see that they do not accumulate year after year until they are funded into a consolidated debt by passing a Consolidation Act. This process is as dangerous "as issuing warrants" on the empty treasury and asking the recipients to discount them at the hands of the bankers who would of course collect them from the treasury as soon as it is reimbursed by the payment of taxes. The "shaving of warrants" always develops into a serious abuse and there is no reason why the Treasury should not properly liquidate all claims upon it. The most important principle in public expenditure is that what is chargeable against revenue must not be charged against capital or what is chargeable against capital must not be charged against revenue. The difference between the transactions in credit and transactions in capital must be grasped and practical finance must pay heed to this distinction.

The Controller of Currency has sometimes tacitly admitted that maturing Sterling Treasury Bills are being repaid by a regular long-term loan, a practice that has to be severely condemned for it leads to contracting regular loans for meeting current expenditure. Long-term borrowing is to be contracted only for executing public improvements

which cannot be paid out of current revenue or when emergencies like wars involve huge expenditure which cannot be met by revenue from taxation. Prof. A. C. Pigou says, "It is generally agreed that the funds for Government expenditure devoted to producing capital expenditure .... the fruits of which will subsequently be sold to purchasers for fees ought to be raised by loans."[24] If only the whole of the loan was needed for railway expenditure it can be easily justified. But a part of it was utilised for paying off maturing Treasury Bills, *i.e.*, temporary borrowing.

Temporary borrowing during the course of an year is justifiable specially during days of greater expenditure than the collected revenue. "Deficit financing" is now given up as unsound policy and a bad expedient. If it is pursued each year it can only be put an end to by consolidating the indebtedness into long-term loans. The balancing of the budget is now the accepted feature of public finance and one year with another the surpluses and the deficits ought to balance. Again there should be systematic arrangement of the different forms of debt when a constant use of them is being made and strict business principles should be followed in the matter of borrowing either by the Treasury or the Government. Opportunities should be afforded for all classes of people to invest in the public debt. Although Adams says[25] that a widely diffused debt does not indicate a healthy condition of political and industrial society still desirable social consequences can be reaped.

Distorting the Truth.

Sometimes also it is the recognised policy of the Government not to place reliable information as regards the object of floating a

[24] Dr. Hugh Dalton, however, considers that it might be advisable to finance a large part of the capital expenditure, if it is possible to do so, by means of taxation as "it prevents the breeding of needless unearned income and makes for a less unequal distribution." It should be "one of the prominent features of the public finance of England as well as that of other countries, says Hugh Dalton. It is only the underlying truth of the statement that made Sir Basil Blackett remark that he would like to finance unproductive expenditure such as building New Delhi out of pure taxation revenue alone instead of by loans. See the Assembly Debates, Vol. III, No. 48, p. 293.

[25] Sir George Schuster, an ex-Finance Member, always defended himself while floating loans in January by saying that financiers in London give the best attention to these *loans* and better rates can be obtained in January alone.

sterling loan. Apart from this, loans are sometimes floated at times when firm money conditions are prevailing in London [26] All these go to prove that financial mismanagement is sometimes responsible for the increase of the public debt of this country. The policy of purchasing sterling in India itself is forcing the Secretary of State to float Sterling Treasury Bills.in London to finance his own requirements. The success of the policy of the purchase of sterling to finance the Home Treasury is dependent o n not only th͏ Indi an cash balances in the Indian Treasury or the Imperial Bank, but on the conditions prevailing in the Indian as well as the London Money Markets. It is only when remittances to the Home Treasury prove insufficient that recourse to the Treasury Bills is justifiable. The policy of purchasing sterling in India will have the defect of forcing the Secretary of State very often to have recourse to the Sterling Treasury Bills if the remittances cannot be made at the proper time owing to weak exchange conditions in the Indian money markets or very firm money conditions in the London Money Market which make the exchange banks and other financial houses unwilling to part with their sterling resources.

The purchasing of sterling securities to be placed in the P. C. Reserves to expand provisional currency in this country to satisfy the business requirements, is another makeshift device which has to be strongly condemned. So long as the Government continues to be the currency authority this method of seasonal expansion would be resorted to. This is as bad as the expansion of seasonal currency against the creation of *ad hoc* securities of the Government of India and placing them in the P. C. Reserve. The only honest and desirable way of meeting *seasonal* expansion is to create the Central Bank of Issue and empower it to meet seasonal demands without any undue raising of the bank rate. The evolutional trend of international and foreign banking is in this direction. India must continue to learn the desirable things of the West and adapt them to suit her own domestic conditions.

It would be far more rational to ask the Secretary of State to utilise the Gold Standard Reserves for meeting his temporary require-

[26] See H. C. Adams, "Public Debts," p. 43, *et seq.*

ments and after the pressure is over due re-adjustments of the funds can be carried out as soon as possible. This was actually suggested by Sir M. Hailey when he was Finance Member in 1919-20. Similarly the Gold Standard Reserve can be made to help the P. C. Reserve during seasonal times. The question of limiting the Gold Standard Reserve to £40 million and adding the rest to P. C. Reserve to wipe out the created securities is too well-known to need any repetition. There is also no clean-cut partition in the practical operations on the Reserves, the P. C. Reserve and the G. S. Reserve. So it would not be wrong to suggest this use of the G. S. Reserve Fund. Till a complete amalgamation of both according to some comprehensive plan of currency reform is forthcoming this use of the G. S. Reserve would not be unjustifiable. The separate standing of both the *Reserves* can be kept up if it is liked and as overlapping is more often the case why should not the G. S. Reserve help the P. C. Reserve specially during the emergencys eason ? Now that all those reserves have been placed in the hands of the Reserve Bank these uses might be eliminated altogether.

Whatever might be the inner motives underlying the contracting of sterling loans which are known only to the financial advisers and cannot often be justified on the accepted principles of public finance, there is no reason on the part of the Government of India to persist in this unwise policy. It should yield to popular wishes in this respect and create a Central Bank of Issue and count upon its sagacity to solve these problems. This hand to mouth policy has to be given up. Dependence on the ways and means advances to tide over temporary requirements is far preferable to this policy of muddling through somehow or other. The remittance programme can be entrusted to it and when adequate funds are remitted without causing any disturbance to the money market there need be no occasion to resort to the contracting of sterling Treasury Bills in the London Money Market. It would also lead to a development of the Indian banking system and enable the Government of India to count upon the resources of the Indian Money Markets to secure the full quota needed for their increasing capital expenditure requirements. It would enable the money market to function smoothly and the seasonal demand for emergency currency can be created on a sound and businesslike basis by the Central Bank of Issue. All roads lead to Rome and if banking,

currency and financial reforms are to be achieved it can never be done without a Central Bank of Issue.

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CHAPTER XXII

The New Rupee Sterling Standard.

1. *The Suggestion of the Reserve Bank Act.*

The most serious economic problem facing the country is the linking of the rupee to the inconvertible sterling. As its continuation has been secured by the R. B. Act of 1934 attention must be paid to this issue.

2. *Most Controversial Topic.*

It is the most controversial topic as the entire Indian Commercial world holds diametrically opposite views to those of the Government, the British traders and the importers.

3. *Too brief a period.*

The short period for which we have been on the sterling standard (Sep. 1931 to Oct. 1933) does not warrant us to draw any definite conclusion as regards the desirability of the sterling link or otherwise.

4. *No positive results as yet.*

No decisive answer has been afforded by history as yet. Neither have the heavens fallen and rendered Indians more destitute than before nor have any substantial advantages accrued to Indian exporters, industrialists and the Indian Government.

5. *Proviso as regards future monetary policy.*

The future monetary policy of the nation would however be decided afresh when the world adopts definitely a certain monetary standard which might or might not be based on gold.

6. *Interr egnum.*

Till the final date of adoption of a world monetary standard, India is to continue the present link with sterling which means monetary autonomy isto be sacrificed during the interregnum.

7. *An ambitious monetary standard.*

So long as it is a ' makeshift device " and not an ambitious monetary standard aiming at the dethronement of the gold standard there is nothing to cavil at this measure but even this consent means that the realisation of the immediate monetary issues of the country has to be abandoned. The Rupee is to be dragged behind the chariot wheels of the Bank of England. The most urgent monetary issue is the raising of domestic prices and nothing solid has been done in this direction.

8. *Conflicting views.*

Most divergent views are expressed as regards the desirable monetary standard. The foreign capitalists vote solidly for the sterling standard.

The scientific economists agitate for a sound and stable monetary standard which can be managed in the wider interests of the country.

There are some who place faith in the efficacy of the " managed gold standard " and exhort the world to play the rules of the honest gold standard in an intelligent manner which is not in the least warped or swayed by economic nationalism. A few of the old-fashioned economists still yearn for the resurrection of a silver standard which in their opinion is best fit for a really poor country of the stamp of India, China, and the country of the Far East. Though a decisive and significant reply could be afforded during the deliberations of the Chamberlain Commission an almost half-hearted answer couched in most nebulous terms was the ultimate recommendation. Based on the above statement that India should be given that standard for which the people have been agitating the curtain was dropped in a deft manner on this somewhat acrimonious controversy. But they

have not lost their courage in their attempts to resurrect the shattered silver standard. America's Silver Purchase Act made them more vociferous in their clamour for the resurrection of silver standard.

There are some who want a managed Rupee standard based on some kind of Index-Numbers and the valuation of the Rupee in terms of gold and foreign currencies should be at a lower level.

Some economists ardently desire the adoption of symmetallism which practically means the mixing together physical quantities of the precious metals, *i.e.*, gold and silver, which have equal value, are combined together. The official ratio for mixing gold and silver should be 1 : *35* or 1 : *32* whichever happens to be nearer the average commercial ratio of gold to silver.

9. *Popular Ignorance.*

In this welter of seemingly confused notions the laymen do not recognise the deep significance of this monetary controversy. The intermingling of social issues with monetary problems has been of a most complex character. Consequently popular opinion stands baffled, dazed and almost blindfolded. It tacitly approves any opinion which the verdict of the Legislative Assembly might decide. It is necessary however to state the *pros* and *cons* of this measure.

10. *The Old and the New Paper Sterling Standard.*

The old paper sterling standard which was enforced on England was the result of the breakdown of the gold standard on September 21, 1931. The new paper sterling standard was the result of the breakdown of the World Economic Conference, the abandonment of the gold standard by America and the amazingly stubborn attitude of the 'gold block' countries. It dates from June, 1933. The most outstanding difference between the two standards has to be grasped. While the old sterling standard was a defensive move to protect the national gold reserve, obtain temporary relief from external competition at the hands of the gold-standard countries and raise internal prices by pursuing a gentle reflationary policy, the *new sterling standard* is an aggressive measure to humiliate the old-

standard countries.[1] Aided by the Exchange Equalisation Fund and a consciously managed credit policy in working which the Treasury and the Bank of England co-operate with each other, the managed paper pound sterling currency wants to declare itself as a better substitute than the international gold standard whose gear has become deranged as a result of the breakdown of international credit, trade and finance.

11. *Its ambitions outlined.*

It aims at re-establishing the world's monetary leadership in the hands of London High Finance or City interests. It aims at re-establishing the practical superiority of the 'managed currency' doctrine over the "automatic" gold standard conception.[2] It aims at solving the domestic problems of Great Britain and attempts to make the Empire and a large portion of the World realise the necessity of stable exchange rate for securing maximum amount of international exchange of goods while comparative stability of internal price-level is not wholly sacrificed altogether. Finally it attempts to prove to the world that "money" needs as much of "planning" as any other economic field. It attempts to prove the triumph of "planned money" over the chaotic embarrassments which are the concomitant effects of a gold standard which is fast breaking down as a result of the unnecessary load of debts created during and after the War and which have to be repaid in the form of an almost dwindling and evanescent stock of gold when compared with the colossal output of manufactured

[1] My anticipations in this respect have been fully realised by recent events. The Currency Manifesto of the British Empire delegates to the World Economic Conference points out that the ultimate stabilisation of the price level is the objective of the new sterling standard of the 20th century. "It is also an invitation to all nations to join the newly established currency standard in a co-operative effort to stabilise their exchanges at a price level which restores the normal activity of industry and employment, ensures an economic returns to the producer of primary commodities and harmonises the burden of debts and fixed charges with economic capacity." See Sir Charles Morgan-Webb's 'The Rise and Fall of the Gold Standard,' p. 144.

[2] Right Hon'ble Reginald McKenna says that the sterling's purchasing power was more stable than that of the dollar or the gold. Gold has continuously increased its purchasing power and brings roughly 15% more goods and services now than in Sept., 1931. (January 1933—Speech before the Annual Shareholders' meeting, Midland Bank.)

goods rendered possible during this age of Technocracy. It aims at internal stabilisation of prices during these days of international price instability through a managed paper currency, allowing exchanges to be looked after by an Exchange Equalisation Fund. In spite of these promised advantages arising out of the new sterling standard there are many who insist on a return to gold and gold- based or backed currency for it alone can possess a *reasonable value of its own.* This instinctive liking and veneration for gold does not give it its real value but it teaches us that the principle of limitation after all gives value to currency.

12. *The widening of the " Sterling area."*

Failing to remove the great obstacles in the path of successful adoption of the gold standard the new sterling standard is being enforced on all countries. Canada joined the " sterling bloc." South Africa did the same and when the major gold-producing countries of the Empire gave up monetary use of gold the possible early resurrection of international gold standard is impossible to be achieved. But the ' sterling area ' or ' planned money ' might not again mean any salvation either for England or the Empire or the world.

13. *The effects on England.*

Taking Great Britain into consideration it means that all the expected advantages of abandoning the gold standard have not been realised. The maintenance of a managed paper currency, the avoidance of deflation, and the pursuit of gentle reflation were expected to tide over the general financial crisis and to raise the prices of primary products. A political crisis supervened and made matters worse. Apart from temporary raising of prices the wider industrial situation and export trade of Great Britain have not secured *permanent relief.*[3] Her strong trade unions and her unemployment insurance have

[3] The statistical summary of the Bank of England for November, 1933, clearly shows " that prices of primary products could not be raised by monetary action." The recent Review of the Trade of India endorses the same opinion.

conferred a rigid economic structure which has refused to adapt itself to changing economic conditions brought about by depression and falling prices.

The Empire has solidly voted for an *international* monetary standard and never even made mention of "sterling area" at the recent Ottawa Economic Conference. Apart from protecting the interests of the gold industry these countries wish to maximise their trade conditions and mutual services to each other.

Even granted that the new sterling standard or "sterling area" is accepted the world itself would not be happier under the new regime for the perrennial quest for securing sound and stable money will not be solved thereby.

14. *What about India ?*

Should India accept the new sterling standard ? From the practical standpoint there is no other go except the one of accepting this standard. India has not evolved the frame work of an independent monetary system—for example as Sweden has done. Without popular instinctive liking for the system the new monetary standard cannot be foisted upon them. The linking of the Rupee with paper sterling commenced on September 21, 1931. On 24th September, 1931, the Government of India undertook to support the sterling value at 1*s*. 6*d*. by means of the sale of Reserve Councils. Nothing abnormal happened except the increased export of gold consequent to the depreciation of the Rupee and the sterling. This export of gold is often mentioned as having been a god-sent feature strengthening Government's credit, India's exchange rates and indirectly helping London to repay her American and French debts.

15. *India's experience of the paper sterling standard.*

The issue is not so narrowly confined as the Government apologists think it to be. Writing on October 6, 1931[4] I had the

[4] See my article "India, the Gold Standard and the Crisis"—October, 1931, Calcutta Review.

opportunity to comment on the possible *pros* and *cons* which would arise out of the linking of the Rupee with the paper pound sterling. In a paper read before the Bengal Economic Society I pointed out the following advantages arising out of the linking of the Rupee with *inconvertible* sterling at 1*s*. 6*d*. ratio.

(1) " There would be an exchange bounty on Indian exports to other gold-standard countries. As India's trade is more with gold standard countries than England there is a temporary stimulus at least as a result of exchange bounty on Indian exports to these countries." A glance at the recent trade figures would prove that a certain improvement has resulted but this has been due to other causes than the sterling nexus. The gradual lifting of the depression is responsible for it.

(2) " The Government of India will not lose anything in the payment of sterling obligations. If a fall in the rupee sterling exchange were to take place it would increase the amount of rupees to be laid aside to pay the sterling obligations. Without a stable sterling rupee exchange the Indian Budget would become ' a gamble in exchange.' " This benefit has accrued but the possible gains arising out of this remittance factor have not been placed by the finance member before the country.

(3) " Without linking to sterling the gold value of the rupee would fall to a very great extent." If the Indian monetary system had been fully prepared for this contingency there would have been some gain arising out of it. Our unpreparedness has forced us to make the Rupee lean on another country's currency. It will continue to be so so long as the credit and currency system stands undeveloped.

(4) " The Indian market is secured to British exports as against the competition of manufactures of the gold-standard countries. This tantamounts to giving Imperial Preference by back-door methods." A glance at the Trade Reports would show that in certain lines the position of Great Britain has improved. Recently Imperial Preference has been granted and the resulting improvement might be due to the second factor.

(5) " An element of uncertainty in the trading relations with England which amounts to 25 per cent. of our total trade would be

removed." The remitters also stand to gain by stable rupee exchange at 1*s*. 6*d*. Apart from the fact that it is sectional advantage it must be understood that these advantages have been reaped by maintaining the *status quo*, *i.e.*, continuation of the stable-Rupee exchange ratio.

(6) "The Rupee will depreciate and the internal value of the Rupee falls, *i.e*, prices of commodities wil lbe rising." This temporary advantage has not come up to the expected level and the price of agricultural raw materials are still on the descending scale. Notwithstanding the slight improvement there has been no significant advance in internal prices so as to make the producer's position tolerably happy.

(7) "The frantic efforts on the part of the Government to support 1*s*. 6*d*. gold value for the Rupee would cease." This has ensued out of the maintenance of *status quo*. The export of gold has strengthened India's exchange ratio and if this ratio were to be maintained the gaps in exports ought to be filled up by gold export. Without this factor the exchange situation would indeed have been gloomy.

While pointing out the disadvantages of the sterling (inconvertible) link I necessarily drew attention to the following features:

1. "Indian import trade with gold-standard countries becomes impeded. As goods pay for goods the Indian exports will become ultimately restricted." Since these lines were written trade with depreciating exchange countries alone like Japan has increased enormously much to the detriment of competing Indian manufactured goods. The position of the Bombay cotton industry is a sad illustration of this tendency.

2. "The changing of the currency standard is a violent breach of national faith. The gold standard countries are justified in considering this step as a betrayal of national trust." The fiction of maintaining India on one shape or variant of the gold standard has always been the well-known currency tactics pursued by the authorities of Whitehall. Strangely enough this fiction is still being maintained by the Reserve Bank Bill which values the Rupee at 8·47512 grains of gold. This intellectual dishonesty has to be frankly condemned.

3. "This gives an excellent opportunity to secure long-term credit in gold countries and pay off sterling obligations out of the funds

for sterling has become depreciated in terms of gold. From \$4·88 cents the pound sterling sometimes fell to a low extent of \$3·20. There would indeed have been 33⅓% decline of sterling indebtedness of ours arising out of the abo ve step." But no positive administrative action was taken.

4. "There would be flight of capital for there is lack of confidence in the Rupee and the Indian monetary system." This was indeed averted by the promise of Whitehall authorities to maintain the stable exchange ratio of the Rupee at 1*s*. 6*d*. sterling. The limiting of exchange requirements in the beginning to Rs. 25,000 alone had the necessary result in eliminating speculation. It is indeed true that these restrictions have been eliminated. The flight from the Rupee would have been indeed noticeable if the credit of the Government had been lowered. But as there was improvement in this direction no great outflow of capital has indeed taken place But as no banking authority ever undertakes to enlighten us on this vexed topic nothing dogmatic can be asserted in this direction.

5. "It is a sad mistake to maintain the standard of value with the incidental and varying circumstances of exchange." A change in the currency standard was ushered in although the fiction of 1*s*. 6*d*. exchange ratio was maintained. 1*s*. 6*d*. (paper) sterling is quite different from 1*s*. 6*d*. (gold) sterling. As England herself is contemplating a return to gold perhaps at a devaluated rate the aim of the Indian currency authority ought to be the same.

6. "Unless an embargo on gold is placed India would be drained of all its gold stocks." A Brahmin is indeed gifted with the capacity of prophesying events. The veritable outrush of private gold stocks to secure higher prices has produced a serious situation. The loss of this stock of gold would be felt at the time when the return to gold standard becomes an accomplished fact. The private gold hoards which would have acted as a secondary line of defence have almost disappeared leading to a weakening of the situation.

7. "It places India at the mercy of currency and credit changes in England. This monetary subordination to the foreign centre turns out to be misplaced reliance in the long run as soon as sterling depreciates further and further." This contingency has not indeed arisen but the apparent disadvantage of depending on another country for regulating our currency is the height of currency folly.

16. *The contention of the Government apologists.*

Such must be the balance-sheet the details of which ought to be filled up before anything in favour of the sterling standard can be suggested. It is a mistaken assumption on the part of the Government apologists to attribute recent improvements to the linking of the Rupee with sterling. As a matter of fact it was the supplementary budget of November 1932 which has strengthened the credit position of the Government of India. Sterling loans can indeed be floated easily while the sterling link is not snapped. Better terms can also be secured if the other Governments have not a relatively strong position when compared with that of the Government of India.

But so long as the domestic capital market is not tapped properly for genuine capital requirements of the Government, access to foreign or external market is a culpable crime. Great Britain's advantage over gold countries in trade relations with India is one feature responsible for slight improvement in mutual trading relations. Apart from traders who say that trade with gold-standard countries is being handicapped there are economists who deplore the inability of the Government of India to control the currency system. They openly assert that the present system does not command the confidence of the public. They would tend to consider the measure as a makeshift device and does not solve the real currency problem facing the country. Except the maintenance of stable exchange at a high ratio for the Rupee by some method or other there has been no other objective in the minds of the respective Finance Members. No finance Member has thus so far given us an intelligent outline of the volume of savings arising from remittances and increased import trade. The producing community has suffered severe loss as a result of currency changes. No amount of tariff protection designed to help the Indian agriculturists and industrialists will enable them to face with equanimity the losses arising out of the currency policy of the country. Control over the whole field of currency and exchange is denied by virtue of the inauguration of this policy.

17. *A Currency Commission.*

Unless a Currency Commission wherein India is represented manages the sterling currency there will be no confidence in the

stability of the monetary standard. The more there is of the element of management the less will it be popular, for the laymen do not consider any currency which does not boast of a gold link as a sound and honest currency standard. It is on the rock of the innate distrust of the people that the ship of the new sterling standard might founder. There is no principle of automatic mechanism in the new sterling standard. The volume of money created under the new sterling standard depends on the management of the Central Bank Governors. They might not be absolutely independent of political influence.

18. *Not yet International Currency.*

The inability of the new sterling standard to secure sound and stable exchange rates with gold countries would lessen its utility. So long as the currency world stands divided into two halves it is impossible to achieve success. A currency standard should be international in scope, extent and usefulness.

19. *The other alternative standards.*

The other alternative standards, *viz.*, the adoption of the Silver Standard by the Eastern Countries is impossible to be achieved (*vide* my articles on Remonetisation of Silver—the Stabilisation of Silver, in the Indian Journal of Economics) Bimetallism is a mistaken recipe of 19th century economic thought. Having lost faith in metallic currencies which would impose difficulties on all countries in these days of technological advance, rationalisation and improvement in business organisation, a currency standard which allows the expansion of money co-equally with productive ability but renders speculation impossible at the same time and would also defeat the hoarding propensity of the people is needed. Until such a type of currency standard is developed by human ingenuity it is impossible to stick to the new sterling currency standard as a permanent currency mechanism.

20. *The Gold Bullion Standard.*

Some variant of gold standard other than the specie standard type is needed. Economy of gold holdings being a primordial consideration

either the gold bullion standard or the scientific gold exchange standard or a variable gold standard have to be resurrected. The managed gold bullion standard being infinitely superior to the gold exchange standard has to be revived. Dr. Mlynarski in his paper before the Gold Delegation Committee has wisely pointed out the defects of the international gold exchange standard. It is a matter of consolation to note that Sir Basil Blackett, who so eloquently pleads for the Gold exchange standard before the Hilton-Young Commission, has himself come round to advocate a managed paper currency or "planned money" to cope with present-day breakdown of the gold standard.

21. *The future gold output.*

Now that the statistical position of gold output is much improved in 1936 and as new forms of business organisation can aid the successful functioning of the gold standard the internationalising of the gold standard at a new level (probably a devaluated one) of gold values for respective currencies can be pitched upon and made to work successfully. A much lower value for gold than at present would enable it to perform the work of the international currency standard. A scrapping of the bonds of indebtedness payable in gold alone would give it a fair chance to do efficient currency work. After all when one remembers that there is no better currency standard which human intelligence has evolved the somewhat reluctant acceptance of the best of the existing standards, *viz.*, the international gold standard, seems to be a foregone conclusion.[5]

22. *The future monetary goal.*

India would gain most by an orderly monetary policy which aims at the resurrection of the variable gold standard or the gold bullion standard which the C. R. Bank should be managing successfully so as to prevent concomitant deflation attendant on the gold standard form of currency organisation. The greatest possible economy of gold

[5] All the adverse critics of the monetary programme of President Roosevelt emphasize on the necessity of an early return to the gold standard system, *vide* Dr. O. W. Sprague, "Recovery or Common Sense," J. P. Warburg, "The Money Muddle."

holding will enable the country to remain on the gold standard but the Central Reserve Banking policy should aim at preservation of gold standard and at the same time secure expansion of bank credit and legal tender currency to satisfy the legitimate productive requirements in a manner as not to destroy the stability of the value of money.

23. *The new sterling as international standard.*

A currency standard means a standard of value. It must have a fixed unit of value attached to it through all time and at all places before it can be considered a satisfactory international standard of value. Gold, for example, had stable value round £3 7*s.* 9*d.* and £3 17*s.* 10*d.* and half. Roughly for a century, 1822-1914, it was international standard of value when it broke down as a result of war-strain. A pound-sterling had fixed value all throughout this period. Throughout this period it was well-nigh considered as a true scientific standard in spite of apparently slight defects.

24. *The object of the currency standard.*

Just as the yard—the physical standard of length—is fixed and unvariable so also the currency standard, whether based on metal or not, ought to be comparatively stable in value. Experiencing great convenience resulting out of fixed standard units of length, weight, and volume we expect similar conveniences to arise from the currency standard as it is used in daily transactions of exchanges of goods and services. The international stabilising of the purchasing power of the currency unit whether it is linked to gold or not is the main objective of the currency reformers. As no single country can hope to secure this stabilisation it has to be done internationally by the adoption of a common policy agreed to at the beginning.

25. *Objectives of international currency standard.*

A currency standard to have any value must be international in extent, scope and width. A purely domestic currency might secure either stabilisation of prices or exchanges according to its own primary

requirements. Countries having large foreign trade might consider stabilisation of exchanges as more important than the illusory and difficult one of stabilisation of domestic prices. Even this policy must be subjected to great difficulties if international monetary or financial conditions tend to alter. Again there is the theoretical impossibility securing stable exchange between countries without stable prices, for the exchange rates of countries are merely an expression of the relative price-levels between the two countries. Now that both America and England come round and have a uniform meaning attached to the word " stabilisation " the logical meaning of the word stabilisation happens to be that of stabilisation of internal prices. An international currency standard must not only give mere tolerable stability of world prices, internal prices, comparative stabilisation of exchanges but stabilisation of money incomes and economic stabilisation. The main problem now is whether a given weight of gold or the unit of the pound sterling or the unit of the dollar can afford to give us the much-desired-for solution. Freedom of commerce, and free movement of capital have to be secured by a common currency standard prevalent in all countries of the world. World production and world standard of living ought to expand progressively.

26. *Present-day currency situation after the W. E. Conference.*

Since the abrupt winding up of the World Economic and Monetary Conference of 1933 due to President Roosevelt's determination to pursue a new monetary policy with reference to the raising of the internal prices to the 1926 level and the stabilisation of the same at that paying level, Great Britain had to delay the restoration of the gold standard and pursue the same monetary tactics, *viz.*, the raising of the internal price-level and the stabilisation of the sterling prices at paying level. Though this policy had the primary objective of the lifting of the country out of the morass of economic depression still the securing of a stable currency standard, managed though it might be, seems to be apparent in the minds of the currency reformers.

27. *The triangular duel.*

The *Gold bloc* headed by France wants to restore the gold standard as the international currency standard and hopes to play the

rules of the game of the gold standard in right earnest in spite of the radically changed circumstances of the modern world. The output of gold, the distribution of gold and the hand-to-hand circulation of gold have changed entirely. To hope to restore the international gold standard in the light of changed circumstances and without securing uniform currency co-operation on the part of the important countries of the world to fix the long-period value of gold, is only to court a precipitate failure.

The *sterling bloc* or the Imperial bloc wants to prove the efficacy of the " managed currency " tied to an Index standard as a much more efficacious one than the gold standard. With the significant boast that the old international gold standard could really become international as it was in reality sterling standard, some of the British Economists hold the opinion that the new sterling international standard would make it realise the ideal of internal price stabilisation.

The dollar standard has once again received a new orientation by being devalued in terms of gold. The euphemistic phraseology that America has restored the gold standard and has permitted the exportation of gold is being used in economic circles. I have elsewhere pointed out that it is in reality a gold-fish dollar.[6] Evidently both America as well as France are each expounding their own meaning of the gold standard while Great Britain, in spite of certain pronouncements of some banking authorities, has been adhering to the new sterling standard and is ambitious enough to imperialise it. It proposes to internationalise it in due course of time. Imperial it has become already by virtue of the findings of the Ottawa Economic Conference. Were there to be a solemn pact between France, Great Britain and the U.S.A. to run their respective standards with the main objective of stabilisation of internal prices the realisation of an international currency standard would become feasible.

28. *Gold as international standard.*

Wittingly or unwittingly the Macmillan Committee tolled the death-knell of the international gold standard currency. Some inter-

[6] See my paper 'Some Currency Measures of America and their Lessons for us.'

national economists like Prof. Gustav Cassel have been exhorting the world to play the rules of the game of the gold standard.[7] He proposes taking vigorous steps to return to the international gold standard and yet guard it against the dangers of economic nationalism and policy of protectionism which would inevitably be enforced on the gold standard countries.[8]

Apart from certain objections against the gold standard which have been repeated *ad nauseam* some more definite objections of a plausible nature would have to be considered by the economists and the enthusiastic supporters of some variation or other of the gold standard. That the long-period value of gold is less stable than that of eggs as Prof. Fisher points out is too true to be disputed seriously by anyone. The future output of gold is likely to be insufficient to meet the increasing demand for roughly £2,000 mil. worth of gold exist at present.[9] The present maladjustment of gold is being intensified by the action of the debtor countries of the world. A modern gold standard in spite of all possible economies of gold would place the industries, agriculture and commerce of the nation "under the harrow." All reasonable propositions for the extension of the national wealth of the country would tend to become defeated as the gold basis of credit cannot expand indefinitely. An omniscient management of the gold standard might not exist even if the Central Banking policy is wise enough and International Central Banking co-operation of the right type exists. An economically disjointed world and politically unstable countries can secure no favourable atmosphere for the working of the international gold standard. Policies of economic nationalism tend to make the currency and credit mechanisms absolutely rigid. The futility of maintaining a high cost of sterile metals as cover for note-issue of a mixed 'gold-credit' standard is after all, opening the eyes of the countries to realise the enormous waste involved in maintaining the gold standard or any other metallic standard for that purpose. The impossibility of securing an absolutely stable exchange rate between countries on the gold and other countries on the other metallic standards has to be recognised. For

[7] See the Mysore Economic Journal, Sep. 1934, p. 514.

[8] *Vide* first para., p. 145. The Rise and Fall of the Gold Standard by Sir Charles Morgan Webb.

[9] See Gustav Cassel, "The Downfall of the Gold Standard." At present there is excess gold supply. See the 7th Annual Report of the B. I. S.

example 34 out of 45 countries have left the gold standard since Sept. 1931. Finally gold with its erratic value fosters cyclical tendencies of expansion and depression. There is no stability in the long-period value of gold, *i.e*., while mere stability of exchange rates can be secured there is no stability of the gold standard. Technological improvements mean absolute deflation and fall in prices as gold and credit cannot expand in a parallel direction along with the mass production of modern manufacturers. After all the recent world depression is a convincing proof of the above statement. The gold standard has meant uniformly and everywhere unstable prices and vast unemployment.[10] It fails to provide the world with a stable internal measure of value Internal money under the gold standard regime means a complete divorce of the laws of supply and demand. The foreign exchange market does not exercise a quick corrective. The gold points fixed by the Government do not automatically regulate the vagaries of the exchange market. Sudden withdrawals of gold, flight of capital due to nervousness on the part of the capitalists and internal hoarding propensities would tend to defeat the working of the gold standard mechanism unless the Central Bank of the country has already garnered a large stock of "free" gold reserves. The chief evils of the old gold standard can be briefly summed up as "gold shortage, gold maldistribution, gold hoarding, gold reserves, gold raids, gold flights, and gold deflation." Gold is a wasteful and highly disturbing regulator of international exchanges. Without a *world bank* the abnormal costs of transmitting gold from country to country cannot be altogether avoided.

Imperially inclined Great Britain has been demonstrating the stability of inconvertible sterling prices and is scoring a decisive victory over the stability of gold prices which are on the ascendancy since Right Hon'ble Reginald McKenna was making his famous pronouncement in 1933 January to the shareholders of the Midland Bank. The uncertainty with reference to the future of the gold prices and their

10 Mr. Keynes points out in his new book, "The General Theory of Employment, Interest and Money," that a favourable balance of payment was necessary to secure low interest rates. But this meant unfavourable balance for another country and the burden of unemployment is thus shifted to other countries under the gold standard. Hence he advocates independent monetary policies for countries aiming at an increase of internal prosperity. This is the right way towards securing a satisfactory basis for international commercial intercourse.

dependence on future monetary policy of the U.S.A. and France mars the possibility of gold being selected as the international currency standard.

29. *What about the dollar as international currency standard ?*

The dollar standard in spite of maintaining the fiction of being on the gold basis is in reality a managed currency since 1934. Any further devaluation of the dollar in terms of gold might be expected if a successful pursuit of the "*new deal*" requires additional finances. The mere word "managed currency ought not to frighten the minds of the thinking world" as Prof. Kemmerer rightly remarks. International currency management is unthinkable in days of currency ignorance. Without a formal code of action governing the dollar currency standard it cannot hope to become the international currency standard. Administered as a national standard aiming at stabilising domestic trade and prices it has the least favourable chances to develop into an international standard.

30. *The prospects of sterling as international currency standard.*

Apart from the significant statement quoted already that the gold standard became the international standard as it was in reality the sterling standard facts tend to favour the sterling standard. There might be temporary weakening of sterling due to adverse seasonal trade factors. The outflow of French short-term funds due to fall in interest rates in London might tend to lower the exchange value of the sterling for the time being. But a well-managed Exchange Equalisation fund exists to steady the exchange value of the sterling in the exchange markets. Sterling prices due to sound management are more stable than the dollar or gold prices. The managing authorities of the sterling standard are tending to link it with the Price-Index. A sterling standard which will make present debts bearable and fix exchange charges on an economic level is the main objective of the currency reformers. As the British Currency Manifesto of 1933 points out, the objective is to stabilise the exchanges belonging to the sterling group. There is universal hatred in England towards the gold standard. It is stated that

"every employer and every worker in every mill, factory, mine or warehouse in the country" is opposed to the gold standard which has brought on in its train such humiliations which have been experienced during the years 1925-1931. The hoarding propensity has received a recrudescence all over the world. A resumption of the gold standard under such psychological influences and conditions would be fatal to its successful working. Ten to one the chances are that the world would be drifting towards the sterling group.[11] Germany is now tacitly on the sterling basis. "Closer collaboration with the gold standard countries," as advocated by the Barclay's Bank, is not tolerated by the Empire countries of the sterling group.

31. *The new significance of the Sterling management.*

The tying of the currency unit to gold or any other unstable metal is impossible to be achieved.

The linking of the currency unit to the chosen Price Index, which was ridiculed by Lord Bradbury, is taking place even while he is alive. The Economist's Index figure is being used as the basis for price stabilisation policy to be pursued by the sterling managing authorities.

That a soundly managed currency can after all confer economic progress on the country is too patent to be disputed now.

The present sterling standard points out the way to currency stability and the realisation of the international currency standard.

It tends to bring about the much-needed economy of gold.

32. *Sterling-dollar as international currency standard.*

Prof. Gustav Cassel wrote long ago that a pound-dollar currency can afford to become international currency if there is a unified Anglo-American currency policy.[12] It would be possible to establish a unified Anglo-American policy involving a parallel and approximately equal

[11] Since these lines were first written the world seems to have accepted the sterling standard as a workable international currency standard. See Gustav Cassel's article on Sterling Standard, Mysore Economic Journal, Dec. 1935.

[12] See the Mysore Economic Journal, Managed Currency, March, 1934.

rise of prices in both countries and subsequent stabilisation of prices at that level. This would naturally lead to a stabilisation of the rate of exchange between their currencies—a stabilisation which in course of time could be fixed as *de facto* and eventually also the *de jure* one. In this way there would be created a pound-dollar currency to which the rest of the world could adhere with assurance as it would doubtless do well-nigh universally.

33. *Why has this suggestion failed ?*

Apart from American prestige which stood in the way of its being linked with pound sterling her *monetary monroeism* as exemplified by its policy at the recent World Economic Conference intensifies the international currency difficulties. It is giving a chance to the managed pound sterling to become international currency. America's progressive devaluation of the dollar, the formation of an exchange equalisation account, the pursuit of internal price stability programme and the refusal to co-operate in money matters with Great Britain are misunderstood by the public and the isolation policy is declared as the policy of currency warfare between Great Britain and the U. S. A. Besides American monetary policy is a part of the N. I. R. Act which might or might not meet with success. If both devaluation of the dollar and credit inflation brought about for financing a policy of extension of public works fail to achieve this end it would cost America a great deal. There is the possibility of a breakdown because "America has an unresponsive banking system, because American people are panicky in nature and prone to hoarding and because American people are addicted to speculation." The entire capitalistic machinery might be undermined by organised labour upheaval. The 60 per cent. devaluation of the dollar is an inflationary force of the first magnitude. Secondly it is contended that by 60 per cent. devaluation the improvement of prices can be halted at the level of 1926 prices as soon as the internal prices rise to this height. The U.S.A. does not mean considering the adoption of the gold link.[13] If the gold standard were to be adopted it would undoubtedly be of the variable

[13] This arises on account of the threat of silver to gold and the possible depreciation of the dollar say perhaps to 50 per cent. of its old value.

type recommended by Dr J. M. Keynes. Many of the gold certificates have been retained but like gold coins they are fast disappearing from circulation. They are bound to disappear in due course of time.

The significant lessons are that internal monetary policy and stability of internal currency in terms of commodities and services are far more important than mere exchange stabilisation in days of international chaos. Purchasing power over commodities should be stable or constant in nature. It might be that powerful expedients to adequately raise and control the price-level might not be available in the armoury of monetary management, but all these circumstances point out the necessity of securing these improvements.

Speculation in the internal value as well as the external value of the dollar has arisen to confound the situation as it were. To check this America has already set up an Exchange Equalisation Fund amounting to two billion dollars. Profits arising out of revaluing gold forms the nucleus of the E. E. Fund. But until a free market for gold exists coequally along with it there will be no salvation. Exchange stabilisation is permitted according to the discretion of the President. Evidently he has not been caring much for it for the external value of the dollar is round 60 per cent. of its old value.

Internal speculation is possible and can be carried on in commodity values or valuation of the different types of securities.

But the Federal Securities Act is tightening the scope for speculation in the value of securities. However, speculation in commodity values might upset this stabilisation problem of the internal purchasing power of the dollar over commodities.

U. S. A. currency reform is only part of the wider problem of national recovery. As so many issues are intermingled there might not be exact success to the desired degree. Right Hon'ble McKenna wisely foreshadows these complications in his recent speech before the Midland Bank, January, 1934. President Roosevelt has to battle against difficulties from which the British authorities are happily spared. He is called upon to bring about business recovery at the same time as he undertakes great social reforms which elsewhere have taken generations to achieve and he is required to do so largely " through the instrumentality of an unresponsive banking system and in face of the problems created by inveterate habits of speculation and occasional proneness to panic and hoarding."

The continued budgetary deficits make the problem of national recovery an extremely difficult issue. National reconstruction work on huge and colossal borrowings is indeed opposed to orthodox principles of public finance.[14] Though certain improvements in industry and banking situation have resulted in the U. S. A. any failure to carry out the scheme would make the situation a hopeless failure.[15] Inflation is a vicious spiral. A constant pumping up of these insidious forces would likely prove fatal to the price mechanism of the country.

The hoarding of gold and currency and dishoarding of the same would depend on the psychology of the people. It would not be possible to influence it by means of Governmental legislation. In spite of penal legislation forbidding the hoarding of gold and bank note currency of bigger denominations, the American people did not disgorge all their hoarded gold and bank notes. This hoarding of currency proved well-nigh fatal to the soundness of the banking system. In spite of their possession of gold stock they had not faith in the stability of their dollar currency. It is indeed true that other forces were clamouring for devaluation of the dollar's gold value and President Roosevelt, in spite of orthodox views of monetary science, was compelled to devalue the dollar.[16] That excessive gold stocks or convertibility of currency into gold are adequate safeguards against the abandonment of the gold standard is a mere disillusion.[17] The Indian people should learn this lesson and give up their mistaken notions as regards the desirability of gold link to their currency. The gold link is valuable in so far as it automatically prevents an overissuing of convertible gold-backed notes and credit currency by reminding the Central Bank of his duty.[18] Beyond this mere utility there need

14 The Recovery campaign will cost roughly Dol. 10,000,000,000 which have to be borrowed during this year (1931). Public debt would swell to 33 bil. dol.

15 G. D. H. Cole prophetically remarks that all that will remain as the ruins of the Industrial Recovery Act will be currency depreciation which will enable America to dump its products on world market tending to lower world prices in terms of gold still further.

16 See the American Ambassador's speech in London before the American Chamber of Commerce—quoted in the Statesman, April 16, 1934.

17 See my article, America and the World Crisis—India and the World.

18 See my article, America's Abandonment of the Gold Standard—The Indian Journal of Economics.

not be any great significance attached to the gold backing of the rupee currency. Convertibility means limitation. It is limitation that maintains the value of our currency.

This attitude of listlessness towards the importance of the exchange value of the dollar, so long as violent fluctuations are avoided, has to be understood. From the beginning the ambition of the President and the governing authorities of the U. S. A. was to increase the export trade of the country. It is not high exchange value of the domestic currency unit that is the true criterion of economic progress. The ability to increase production at a surprisingly low level or cost of production and the finding of an internal or external market for these cheapened goods is the main key to the economic progress of the country. Improved marketing and economic planning are the needed panaceas. Mere destruction of unwanted raw cotton or excess wheat stock denotes planlessness in the field of production. Should not the fetish of high exchange value for the rupee be given up so long as the world economic conditions are considered to be abnormal or upset by special world causes? Right Hon'ble R. McKenna voices the truth when he says, "it is true that the restoration of exchange stability is much to be desired but if the price to be paid for this convenience is too high we must be content to differ from it."

Even if the scheme succeeds the manipulation and artificial tampering with the value of currency cannot but be looked at askance by the economic theorist. The end might not be secured by honourable means. In so far as managed inflation is an effective counterpoise to the terrible deflationary effects of the economic depression there is indeed much to be said in its defence. But uncontrolled and meaningless inflation would mean utter financial ruin and ultimate financial collapse. That has been Germany's past experience. What makes the sober reader pause while reading Mr. Roosevelt's plan is the availability of immense natural forces and raw material resources of the U.S.A. A little inflation might indeed help the task of economic recovery. A recent writer says that "inflation is good or bad according to circumstances and a little inflation is sometimes desirable." Business revival and decrease of unemployment might indeed be secured. As actual improvement has resulted already, as Mr. Bingham the American Ambassador at London points out in his recent speech before the American Chamber of Commerce, one has to bless the

inflationary management of money which has been responsible for this improved situation.

33. *The benefits of international currency standard.*

It goes without saying that "an international currency standard is far more beneficial in its effects than a policy of free trade or protection." Return to economic prosperity may be secured by a stable international currency standard. An international gold standard however excellently managed it might be would fail to secure this at this juncture. Hence a monetary federation of all the leading countries has to be ushered in by a World Economic Conference. As a rise in wholesale prices is essential the issue of regularly renewable treasury bills amounting to average money value of one year's trade between the two member nations has to be made. A par of exchange will be established and made stable for all future transactions by sale and purchase of these treasury bills which should be acceptable by the treasury of each country.

All the countries should uniformly expand their respective currencies in equal proportion to the amount of note-issue and the sight-liabilities of the C. Bank put together.

These newly expanded credits might balance debits, restore salary cuts, etc. Direct and indirect taxation has to be reduced. Governmental and local expenditure on public works might expand.

There should be no expenditure of new credits for armaments. As expansion of new monetary units would raise prices the fixed salaried classes have to be protected by making circulating money legal tender to the extent of the purchasing power of the monetary unit to be determined as the reciprocal value of a suitably constructed cost of living index. The control of credit and currency is to take place through the mechanism of the Central Bank by bank rate method and " open market " operations and the wholesale prices should be established at an established optimum level which would secure fullest employment of capital and labour. Monthly meetings of the Bank Governors at the Bank of International Settlements would lead to discussions tending to improve the currency system of the country. The free import and export of precious metals is to be tolerated.

National banks may buy gold and silver at minimum prices. An Eight-hours working day in all countries has to be secured statutorily.

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CHAPTER XXIII

The Organisation of Capital.[1]

What is capital?—The Indian Capital market—Regrouping of productive factors—Sources of capital. Economy of Public and Private expenditure—Social credit—Purchase of stores—The flow of external capital—Some estimates of external capital—Economists' objection to foreign capitalists—The example of other countries—The example of Eastern Countries—The example of the Colonies and the Dominions of the British Empire—The necessity of capital in India—Means for the development of the capital resources of this country.

What is Capital ?

Capital is the power-house that supplies the energy to the industrial machine. India really lacks both human as well as material capital. By human capital is meant knowledge, skill, experience, and genius. Conservation of human capital is no less necessary than the conservation of natural resources. Material capital is no less indispensable. As a matter of fact it paves the way for the realisation of the other. If the examples of England and the United States of America are considered we find a vast increase in material wealth withheld from consumption mainly in order that it may be used for the production of further wealth. As Ramsay Muir says "in a complex industrial society the nation has to set aside year by year about 1/5 of the wealth for the purpose of keeping our industries going and expanding them. If it failed to do so it would be faced by ruin first as the whole world would die of starvation if all the farmers used up all their crops instead of keeping back a part for seed."[2] In all

[1] A portion of this chapter was first submitted as written evidence to the External Capital Committee in 1925.

[2] See Ramsay Muir, "Liberalism and Industry," p. 44. The total wealth earned in England in 1913 was about £2,000,000,000 and £400,000,000 were set aside for the creation of the new capital and keep the machinery of production going.

economically progressive countries material capital goes on increasing as a result of saving and investment.[3]

The Indian Capital Market.

The economic welfare of society depends on the perfectness of its capital market. A well-organised capital market would mobilise capital and place it in the hands of business ability for its effective utilisation in production. The two elements of economic production, namely, capital and business ability, might be differentiated and the supply of one ensures the creation of the other. The agents of the capital market consider it their duty to bridge "the economic distance between those who possess capital but lack in business aptitude and those who possess the requisite business ability but are incapacitated for lack of funds." Thus the entrepreneur can arise if there is a capable intermediary securing the necessary flow of capital from one hand to another through its own channels. The task of mobilising, multiplying and distributing the capital resources into the hands of businessmen and entrepreneurs who put it to a productive use is the work that is expected out of the capital market.[4] Credit is the real lubricating oil in the whole financial mechanism of the country. The businessmen by virtue of their credit are able to construct a credit structure many times the amount of cash or legal tender money they hold in their hands. Their credit enables them to multiply the capital they possess together with what they obtain as deposits, fixed or current, into effective means of payment which would enable the society to perform its money's work with the most elastic and least costly and highly efficient cheque currency.

In India owing to the absence of a well-organised capital market business and industrial undertakings can be effectively started only by those who combine both capital and business ability in their hands —entrepreneur-investors as they are known. Such rare coincidence of both the factors of economic production in the very same hands, is mainly responsible for the partial utilisation of the raw materials

[3] See L. C. A. Knowles, "The Industrial and Commercial Revolutions in Great Britain," p. 168.

[4] See F. A. Lavington, "The English Capital Market," p. 289. See also A. T. K. Grant, "A Study of the Capital Market in Post-war Britain," 1937.

which nature has lavishly bestowed on this country. Taking the case of England, the banks, the issue houses, accepting houses and foreign exchange departments of the banks are all connected with either the collector of capital or the transporting of it to those who can make a better use of it. The existence of each of these specialising factors reduces the cost of the service that lies in the effective transfer of capital and would give perfect guidance to real investors. The present ignorance of the Indian investors and their fear to undertake risks in the matter of investments are the real obstacles and these can be removed only by the development of an organised capital market consisting of several agents with the ability to minimise the risks and uncertainty in the matter of capital investment. This would increase the efficiency of production and the national dividend. The Indian Government has to do much in this matter of affording protection to the ignorant investors from the dishonest professionals by copying the principles embodied in the German Civil Law which prohibits that companies' shares of a lower face value than 10 from being floated. As Prof. Mitchell says, " the public regulations of the prospectuses of new companies, legislation supported by efficient administrations against fraudulent promotion, more rigid requirements on the part of stock-exchanges regarding the securities admitted to official lists " are required in this country. The U. S. A. has been pursuing the selfsame course and the Securities Act of May 1933, attempts to forbid the offer and sale of unsound securities to the public.[5]

Regrouping of Productive Factors.

It is not only in the field of labour that specialisation, division of labour, ability and special training are adopted and adjusted to the actual needs of the day but the same is the case with capital and land. The natural advantages of land, *i.e.*, its climate, site and, lay out are taken into account and the services of the producing agent are concentrated on a narrow range of functions. Coming to the transport of capital a continued adjustment of its supply to demand or the volume of money

5 See William Macdonald, " The Menace of Recovery," Ch. VIII, p. 195.

work has to be done. The sense of combination, business organisation, and the ability to regroup the productive agents so as to produce highly specialised services are not instinctive, inborn or natural gifts. Any country can learn or acquire these faculties as the U.S.A. has done. Japan followed the model of Germany. "Born at the same time as modern Germany it has conformed itself to the German political system, the German conception of the great game of welt politik, the German method of playing their game, and German efficiency as a method of national expansion.[6] In Japan the Government is closely allied to the trading interests.[7] "Even the introduction of new industries, such as spinning, ship-building, cement and glass was contrived by the setting up of Government factories which were afterwards sold to private owners. A higher council of agriculture; commerce and industry including businessmen is supported financially by the Government and the Government sends out many special trade investigators to foreign countries." Thus the lack of capital and enterprise on the part of the people has to be rectified to a certain extent by supplementing their resources by Government subsidies and financial assistance to the industrialists. Regular banking facilities have to be multiplied manifold as early as possible if India's resources are to be successfully tapped.

Sources of Capital.

Indigenous capital has to be accumulated and invested in industrial concerns carried on on modern scientific lines. India cannot hope to gain by any sudden adventitious accession of wealth as in the case of England and Germany. The Industrial Revolution of England has been facilitated to a great extent by the wealth poured into England from India during the years 1757 to 1857.[8] Germany likewise benefited to a large extent

[6] See T. F. Millard, "Democracy and the Eastern Question," pp. 27-29.

[7] See McGovern, "Modern Japan" or G. C. Allen, Modern Japan and its Problems," chap. " on " Rise of Industry."

[8] This has been estimated at various figures ranging from £500,000,000 to £1,000,000,000. See Brooks Adams, " The Law of Civilisation and Decay," pp. 263-264. See also Digby, " Prosperous British India," pp. 30-31. See Lajpat Rai's " England's Debt to India." See *contra* J. C. Sinha, " Economic Annals of Bengal."

by the French Indemnity paid in 1870. These French milliards helped to swell the mounting tide of industrial and commercial expansion and the influence of the Zolleverin fostered it to a great extent. India has to save more capital and this can only be done by the upper middle class, the rich zemindars, successful professional men, highly paid Government servants, millowners and merchant princes. The Indian wage-earner can hardly be expected to save. According to Mr. G. F. Shirras the total monthly income of the Bombay wage-earners' family is Rs. 52-4-6. Out of this expenditure comes up to Rs. 47-14-5, which is made up of the following items:—

	Rs.	A.	P.
Food	27	2	11
Fuel and Lighting	3	8	4
Clothing	4	9	10
House-rent	3	11	3
Miscellaneous	8	14	1
Total Rs. ...	47	14	5

This leaves a balance of Rs. 4-6-6 and this can by no means or stretch of imagination be called saving. Heavy contingencies arise involving additional expenditure greater than this monthly surplus balance. Expenditure on small charities, and on poorer relations and for marriages and other social ceremonies prevents them from saving. Wages are low and it is impossible for the labourers to accumulate capital. The living margin is small, the saving margin is smaller, and capital can never be accumulated by the low wage-earning labourers.[9] If India is ever to reach the highest possible stage of prosperity all the

9 The same is the case in the rural areas. Any number of family budgets have been collected in the different Provinces and the same tale is repeated by the economists who have connected these village surveys. The recent census of India has given more detailed information under the above heading.

members of the community should be in a position to save a portion of their earnings and employ it for productive purposes. This depends on the fact that all classes have more than enough to satisfy current needs which would lead to automatic economy and the storing of capital to meet future needs or for securing a higher standard of life, or consumption. The average income of the Bombay wage-earning individual cannot be taken as representative of things existing in the whole of India, much less can it be considered as representative of the total people of the City of Bombay. At any rate there is this much of truth that can safely be warranted to be true of all the lower classes of people or employees in this country. They lead a hand-to-mouth existence with neither the inducement nor the opportunity to spend their income in the way that is wisest and most socially desirable. As Dr. Marshall would say these lack the telescopic faculty, *i.e.*, the ordering of present actions in accordance with the future and distant ends. This is not possible for them as the economic reserve in their hands is not much and as soon as it is exhausted household goods are pawned to provide the necessary means for the occasion. Such people can hardly be expected to save and build up capital that can aid the industrialisation of the country. Enforced savings on the part of the low wage-earning people would mean " heavy net cost in the social economy." No part of the economically necessary fund of annual capital ought to be drawn from this sort of saving for " it is literally a coining of human life into instrumental capital and the degradation of thrift in its application to such saving is a damning commentary upon the false standards of social valuation which endorses and approves the sacrifice.[10]

It is the upper and richer class people that can afford to save but unfortunately the so-called rise in the standard of life and its approximation to the European standard is involving the expenditure of more money. The finer and costlier mill-made Manchester dhoties have supplanted the cheaper but coarse Khaddar clothes. Costly coats, shirts and banians are being used instead of the old chaddars. The substitution of the Scissors and Imperial Tobacco Company's cigarettes

10 J. A. Hobson, " Work and Wealth, " p. 105.

for the home-made tobacco and cigars, the use of China glassware and enamelled ware for the old bell-metal and brass crockery, the fine glossy wear for the old ornamented shoes and foreign footwear for the indigenous sandals, the bottled medicines for the Ayurvedic recipes, strong imported liquors for the indigenous ale and arrack, soaps, perfumery and toilet goods for the home-grown soap-nuts, attar and cosmetics, beet sugar for gur and jaggery, costly athletic goods as footballs, cricket and tennis implements and billiards for the old-fashioned swadeshi games as *bulchuk*, the expensive toys and amusement items instead of cheap lacquered-ware wooden toys, the pianos, harmoniums and orchestras and gramophones instead of the *mridanga, dhol and dhak* and house furniture, trappings and other outfit on Western lines instead of the simple and plain home-made drawings, paintings and cabinet furniture is having a threefold effect. Several of the goods mentioned above have no " survival value " and unless there is a rational *selection* and conscious control of the factors of consumption which possess definite survival values there would be scope for error and a mere unconscious, irrational and imitative selection of goods in the standard of consumption is fraught with danger and disastrous consequences to the individual as well as the social well-being of the community. As Hobson points out " such a standard of consumption is trespassing on the economy of welfare.[11] Secondly, there is a drain on the purse and thirdly indigenous handicrafts and cottage industries producing these goods are languishing for lack of patronage. The importation of these luxuries and tawdry manufactures is increasing the powerful hold of the foreign capitalist interests and even our political interests are subordinated to the economic interests of the Empire. The Empire cult which rules all parties, the conservative, liberal [12] and the labour [13] parties realises

11 *Ibid* p. 117.

12 For understanding the Liberal point of view about the advantages of possessing India. See Ramsay Muir, "Politics and Progress," pp. 26 and 27.

13 Lala Lajpat Rai remarks that " Young India should stand by their Keir Hardies, Lansburys and Smillies." But there is no use of this dependence. The first Macdonald Ministry has sanctioned the use of Regulation III of 1818 afresh to curb the existing political situation. He now realises however that Indian nationalism aspires to solve them better than by dependence on socialism and parliamentary help.

that India is essential to the Empire and England.[14] All these parties recognise the "vast array of vested interests," the enormous capital sunk in India, the number dependent on its returns, the importance of Indian products to British industries, the number of British people employed both by the Government and the commercial firms and the army of English people such as merchants, shippers, distributors, producers and consumers whose prosperity depends on the Indian connection. Any snapping of the link between India and England would lead to a social disaster of no small magnitude and is bound to adversely affect the material conditions of the English people. India on the other hand can to a large extent decrease its dependence in trade matters on English industries by sacrificing the use of all articles of "ilth" as Ruskin denounces them. "If there were no luxury there would be no poor" said Ruskin and the luxuries far from contributing to raise wages actually retard their rise.

The richer class people who import these luxuries must sacrifice their luxuries and save the expenditure on trifles, futilities, inutilities, superfluities and fineries of foreign civilisation. They can economise to a large extent on their clothing bill, expensive boots, shoes, western glassware, dietary articles, soaps, perfumery and foreign toys. The imports of manufactured cotton, woollen apparel,

14 See A. E. Duchesne, "Democracy and the Empire," p. 48. See also A. Demangeon, "America and the Race for World Dominion." India is a typical colony for exploitation Immensely rich and thickly populated she represents for her masters at once a fortune and a defence. It is through India that the British Empire assures her destiny. India gives the fleet places of support on the sea-route. India recruits for the army legions of high spirited soldiers; native contingents fight for Great Britain in China and South Africa. During the Great War India supplied more than a million men of whom more than 100,000 men were killed. India is for Great Britain an enormous market; two-thirds of her importations come from English sources. She furnishes 51% of the wheat production of the Empire, 58% of the tea, 73% of the coffee, almost all the cotton. An immense British capital is invested in Indian mines, factories, plantations, railways and irrigation works. India pays the interest on probably 350 million pound sterling. India keeps busy an army of British officials whose salary she pays and whose savings go every year to Great Britain. She pours into British coffers the interest on her public debt, the pensions of old officials, the Government expenses of the administration. More than 80 million pounds sterling a year is the estimate of the sums that India pays in the United Kingdom to her creditors, her stockholders and her officials. And we do not know how much she brings to the merchants who trade with her and the shippers who transport her goods. Never was the term exploitation better applied." See also A. Demangeon, "The British Empire," pp. 238-239.

liquors, foreign boots and shoes, Western glassware, soaps, perfumery and foreign toys can be seen in the following table [15] :—

Article.		Pre-war Average.	War Average.	1919-20.	1920-21.	1921-22.
		Rs.	Rs.	Rs.	Rs.	Rs.
Cotton M. D.	...	5,36,769	5,23,812	5,90,703	10,21,200	5,99,381
Silk	...	27,605	27,700	59,242	55,934	29,870
Wool	...	30,837	18,171	15,983	55,309	12,286
Liquors	...	20,247	23,664	33,741	49,002	37,661
Glass, etc.	...	16,192	12,802	19,981	33,762	22,249
Tobacco	...	7,107	13,242	20,187	29,591	16,506
Tanned hides, etc.		...	...	53,73,020	1,28,62,110	66,48,567
Drugs	...	10,263	12,902	18,250	21,128	15,837

India generally exchanges its necessaries of life for such luxuries as these. The economic meaning of swadeshi is to hit hard the economic imperialism of the "videshi" commerce and to relax its tightening grip on the vital raw materials of our country. The economic happiness of our weavers and other handicraftsmen can never be realised unless the Indian people resort to the *swadeshi* movement. Swadeshi is a positive measure contributing something towards the real revival of the home handicrafts and quasi-industrial pursuits. Economies in the matter of luxuries, superfluities and inutilities are to be made and the money saved has to be liberated for providing capital. It tends to create an atmosphere favourable to industrial development. Some advocates have been pleading for indiscriminate protection to create such an atmosphere but they forget the cost it entails on the part of the people.[16]

The other deeper and wider implications of the habits of the wasteful and leisured rich are beyond the scope of this thesis which is solely

[15] For detailed figures of the other luxuries see the Review of the Trade of India, 1921-24. Recent figures can be obtained by studying the above annual publication.

[16] See Mr. Manu Subedar's evidence before the Indian Fiscal Commission.

concerned with the productive and consumptive uses of the richer classes.[17]

They must be alive to the fact that they hold the " economic nutriment " of all social progress in their hands and instead of applying it to sport, unorganised charity and dilettantism they must turn it into the fruitful channels of art and exercise of life, of thought, activity and of religion. Wise consumption is the be-all and end-all of all economic activity. Ruskin insists on this fact when he says that " there is no wealth but life." This " vital wealth " has to be secured by paying due heed to consumption.[18] A wisely arranged consumption can do much to secure the organic welfare of the community.

A simplified system of living is never inimical to the growth of culture or development of art as some of the votaries of the materialistic civilisation think.[19] Art is only the expression of the emotional stirring in the mind and wealth has nothing to do with the appearance of artistic expression in a society.[20] To simplify the standard of living does not necessarily mean any lowering of the standard nor does it mean loss of real enjoyment. A good many things of our consumption can be given up. " To get most out of life is to put the most into it " and it does not mean the surrounding of oneself with all the luxuries and baubles that one can afford to purchase. " Lewdly pampered luxury " tends to lower national character. Moralists as well as economists point out that the chief uses of wealth and the opportunities afforded by a command over wealth are to make a just use of it in encouraging art, beauty and culture, secure human well-being and moral elevation.[21] As Prof. Urwick says, " the standard of consumption of the rich peopie should rest on a basis of organic utility, expenditure being apportioned so as to provide the soundest and full human life. Current prestige, tradition, authority, fashion and

17 See Prof. T. N. Carver, " Essays in Social Justice," pp. 273, 379-381 also Prof. Ross " Social Control," pp. 407-408.

18 See John Ruskin, " Munera Pulveris,"—L

19 See the article on " Aesthetics in Encyclopaedia Britannica," 4th Edition, Vol. 1, p. 285.

20 See W. T. Sollas, " Ancient Hunters." The bushmen of Africa reveal a high aesthetic talent in the cave paintings and literary traditions.

21 See the Encyclopaedia of Religion and Ethics, article on Luxury, by Prof. W. R. Scott, p. 244.

respectability are not the real things that should displace the individual rational choice in the matter of consumption." Money spent on frivolity, self-indulgence, and in injurious waste must be turned into the fruitful channels so as to increase our economic energy and improve our social heritage. Money spent on the luxuries is not only unproductive expenditure but goes to the foreign purveyors of these luxuries. If this were to be retained in the country and spent on indigenous manufactured products only a shifting of wealth would result in contributing to the accumulation of riches by the *nouveaux riches*. But as these luxuries are foreign articles the loss is a permanent one and the people of the country are permanently affected.[22] It might be argued that if India refuses to buy the other countries' goods her own exports would decrease If we decrease imports, exports will be decreased say the authorities on International Trade. But they do not remember one consideration. Our exports are largely made up of those things which other countries cannot easily dispense with. This is a position of great tactical strength which ought to be taken advantage of. This does not mean that very heavy export duties should be levied nor does it mean that we must restrict our market by going in for Imperial preference in the matter of our export trade. The United States impose a high tariff on imports and inasmuch as her exports are largely made up of those things which other trading countries cannot easily dispense with, they are forced to pay this substantial tax to the coffers of the U.S.A.[23]

"This might not be what the U.S.A. have intended to do," says

[22] Bertrand Russell says the same thing of China. "The development of Chinese commerce by capitalistic methods means an increase for the Chinese in the prices of things they import which are also the things they consume and the artificial stimulation of new needs for foreign goods which place China at the mercy of those who supply these goods, destroys the existing contentment and generates a feverish pursuit of purely material ends. (See the Problem of China, p. 183.)

[23] In spite of the increasing customs duties levied under the most rigidly protectionist tariffs the customs revenues have not fallen and its trade has not been adversely affected. See Prof. Taussigs "Tariff History of the United States," Appendix, Table 1, p 4. Prior to the war the customs revenue amounted to 300 million dollars. Exports continue to flourish in spite of the recent Fordney Tariff and the imports do not show any shrinkage. See Bass and Moulton, "America and the Balance-sheet of Europe."

Prof. Pigou, "but they are in fact doing this" and he remarks that "this is not a generous proceeding."[24]

Adopting a scientific and more ethical living and social life as our forefathers have done much more capital can be utilised for industrial purposes. By this method alone can India hope to stop the economic drain resulting out of the import of foreign manufactured goods and the scope it affords for the commercial and foreign exploitation of the country. This does not mean that the consumption of goods which minister to the social well-being ought to be given up. English books, English machinery, and English Industrial skill are necessary and it is the unessential things alone that we must sacrifice. This drain is not due to exploitation but is a result of our own weakness and if our people resolve to buy only the essential things the sellers of rubbish have to put up their own shutters and burn their wares.

If Indian people are really anxious and sincere in their ambitions for a solid economic and social development nothing is so important as the wise control of public and private expenditure and the proper and profitable utilisation of personal income. The formula of economic retrenchment in private expenditure must be very vigorously preached. The education of public opinion to regard those as infamous who make a misuse of wealth seems to be the only resource we have for dealing with the unworthy rich. At present there is not much progress in this direction. The Indian Government refuses to tax luxuries at a very high rate as the Japanese Government has done.[25] Hence the only effective campaign against these luxuries can be that of educating the people as to their harmful consequences. In modern France the anxiety to build up material capital in order to

[24] See A. C. Pigou, "Essays in Applied Economics," p. 155.

[25] The Japan Magazine says "that the luxury tariff bill has become a law in July 1924. It imposes 100% *ad valorem* rate of duty on all articles included in the luxury tariff. Its list extends to over six pages and a few specimens regarded as luxuries are quoted here. Vegetables, fruits, nuts preserved in sugar, ginger, tea, coffee, cocoa, confectionary jams, biscuits, syrups, cheese, soda-waters, beverages, liquors, skins, tooth powders, artificial spices, essences, fireworks, wool fabrics, silk fabrics, velvets, waterproof fabrics, handkerchiefs, travelling rugs, neckties, shawls, gloves, stockings garters, pictures, post-cards, locks, keys, cutlery, watches, photographic materials, gramophones, fire-arms, umbrella, sticks, walking sticks, billiard, cricket and chess requisites, tennis, baseball, football toys are all charged 100% duty.

repair the ravages of war has led even the peasants of Europe (France) to boycott all kinds of lighting except candles. They have begun to sow more flax and are resorting to the spinning wheel and the hand-loom to provide their own clothing. In some cities societies have been formed of men who agree not to wear cuffs, collars and links. In Spain the most prominent single movement is to substitute catalan sandals which are a traditional form of footwear used by peasants and labourers in the province in place of shoes.[26]

From the theoretical standpoint of view several authorities[27] on public finance advocate heavy taxation on luxuries. Armitage Smith says, " immoderate smokers and drinkers contribute heavily to taxation on account of the consumption of luxuries and it is optional. This taxation raises revenue and imposes no economic burden."[28] Hume says, " the best taxes are such as are levied upon consumption especially those of luxury. Because such taxes are least felt by the people. They seem in some measure voluntary ; since a man may choose how far he will utilise the commodity which is taxed." Decker proposes a single tax on luxuries to raise all the revenue that the state requires. But this is impossible in this country where three-fourths of the population consume no luxuries. Sir Joshiah Stamp proposes levying taxes on the consumption of luxuries.[29] But there is a conspicuous absence of such social condemnation of luxury and waste in our society. The expensive standards of pleasure-getting have to be controlled in our society. There must be a standard of approval and disapproval in the matter of consumption. The standard of approval has to bear in mind the Indian ideals of plain living and high thinking and the standard of disapproval has to check waste and unwise and harmful consumption.

Economic retrenchment is no less urgent in the public expenditure of the Indian Government. Adam Smith[30] remarked that " great

26 See the Living Age quoted from the Modern Review.

27 See D A. Wells, quoted in Bullock's " Readings in Public Finance," p. 78 also Dr. Hugh Dalton, " Public Finance." p. 7 also Hobson, " Theories of the New State," p. 121, and Jones, " Taxation, Yesterday, To-day and To-morrow," p. 96.

28 See Armitage Smith, " Principles on Taxation,"p. 92.

29 Sir J. C. Stamp, " Fundamental Principles of Taxation," p. 74.

30 See Adam Smith, " Wealth of Nations " edited by McCulloch, Bk. II, Ch. III, p. 274.

nations are never impoverished by private though they sometimes are by public prodigality and misconduct. Had he lived in these days he would surely have revised this remark. Dr. Edwin Cannan was correct when he defined "economy " as " the best utilisation of the available means." Our richer classes, flourishing tradesmen and high-waged employees must pursue this ideal of economy. This is not parsimony nor is it opposed to all ideas of progressive expansion and useful development. Our lack of industrial capital forces on us this question of economy and thrift into the foreground of national duties. Besides this reason there is another one why they must give up their love of luxury. " Luxury's contagion, weak and vile " tends to spread downwards from one stratum of society to another with the possible result of a decay of individual and national wealth. It is in the general interest inclusive of their own that these people have to modify their consumption in the particular manner related above. The well-to-do classes can maintain their standard of living but the middle classes would be weakened by their craving for the new wants and desires created by the Western civilisation. To satisfy their cravings by their stationary income living on bad quality of food and sometimes overcrowding are resorted to. This process of " refined starvation " to which the middle class subjects itself and which unfortunately drags itself over a period of years has not been recognised by our economists as yet. Attention has thus far been drawn to the state of the working class people alone. The middle class family has to be raised " to a lofty plane of existence pregnant with fruitfulness, learning, achievement, contentment and good-will." If a weakening of the middle classes were to be allowed unchecked the disparity between labour and capital in our country will be accentuated and our society, which has thus far been free from the taints of socialistic philosophy or communistic doctrines, would soon become poisoned by the presence of those classes which oppose capitalistic society.[31] There would be an agitation to greater equalisation of the economic conditions of life to be secured partly through extended social legislation which will indirectly affect the

[31] Dr. Hadley echoes a similar sentiment when he says, " the First French Revolution was probably quite as much due to the ostentation of the rich as to the pressure of the Government." Economic Problems of Democracy, p. 142.

well-to-do classes as they will have to pay for it in the long run.[32] Thus the unwise consumption of the rich would not only have a direct bearing on the national strength and prosperity but is bound to lead to unpleasant consequences in the long run.

It is not the waste of money alone that has to be seriously regretted. The waste of time that the richer classes can afford to suffer is equally bad. As the Bishop of Birmingham puts it " this is nothing but immoral rest " if the rich people fail to utilise their wealth and employ their time in the improvement of the organic life of society, eradicating civic diseases such as bad housing, lowering, environments, badly founded education and other evils of the society. The Chinese philosopher Confucius says, " the rich people should not perfect themselves but strive to perfect others also and this is the fundamental base of all progress and of all moral development." The happiness of the civic life of the community must be striven for by every citizen and the rich people must not only lead model and true lives but seek to ennoble others and level up the rest of the people to their own life of contentment and happiness. This is the " work-bench philosophy of life " as opposed to the " pig trough philosophy of life " which advises the human soul thus: " thou hast much goods laid up for many years, take thine ease, eat, drink and be merry."

The Development of Social Credit to increase mobility of capital.

Another great desideratum at the present time is the development of social credit as Dr. Marshall would put it. Its presence is absolutely necessary before our society can hope to accumulate large capital. "Social credit arises on account of confidence which permeates all life, like the air we breathe, and its services are apt to be taken for granted and ignored like those of fresh air until attention is forcibly attracted by their failure. It exists as trust in the character of society, in the stability of public order, in freedom from disturbance at home and from foreign attack in the gradual and harmonious development of economic conditions, in the probity of reasonableness of people generally and specially businessmen and legislators, in the society and good

32 See T. N. Carver," Essays in Social Justice," p. 278.

working of that currency which acts as the medium of exchange and a standard of measure for gauging economic obligations and transactions of all kinds."[33] The development of social credit is indispensable before any unlocking of Indian capital for industrial purposes can be expected. It is slowly developing and the time would come when the Indian people can get together and pull together. It alone can make possible a realignment of industrial conceptions on the part of the people who being placed in the circle of modern nations have caught their infection of search for wealth, their keenness for invention and desire for progress, change and innovation. Mercantile and manufacturing business is largely in the hands of foreign capitalists and the accumulation of indigenous capital is difficult. It can only arise out of the surplus of the rich landlords, the high-waged employees of the Government and the few people who are engaged in trade and manufactures. The following table shows the annual averages of capital issues in the different countries.[34]

Year.		Great Britain. (Ms. £)	India (Ms. Rs.)	The U. S. A. (Ms. Dollars).	Switzerland (Ms. Francs)
1913	...	44	669	137	528
1923	...	67	246	4,015	748
1924	...	89	229	4,587	609
1925	...	132	342	5,125	675
1926	...	140	197	5,188	709
1927	...	176	207	6,203	868
1928	...	219	282	6,724	688

Foreigners observe that the Indian people have hoarded wealth which is seldom brought forth into circulation. The reasons for this habit have to be understood before it can be pointed out that they should release a large part of it for capital purposes. It has already

33 See Dr. A. Marshall, "Industry and Trade," p. 165.

34 See the Statistical, "International Year Book," 1928, p. 207.

been pointed out that political insecurity, unfavourable environment, the joint-family system, the absolute dependence of women on the male members of the family, the necessity to spend on social and religious functions, the huge favourable trade balance in favour of India and the distrust of the people in the token currency, have all tended to make the people hoard their capital in the shape of ornaments. The absence of a widespread banking system conducting business on conservative line makes the people depend upon gold and silver as the best means of obtaining money at short notice. The inadequate distribution of the banks and the small scale on which they conduct their business precludes them from extending their branches into the interior and familiarise the people with these new institutions. Though this would first of all tend towards an increase of currency still the banks would be in a position to loan out more funds to industries than before. Thus the development of sound banks in the interior to mobilise as much capital as possible is an important desideratum at the present time.

The Purchase of Stores.

The purchase of stores by the Government of India in this country alone of all its requisites, so far as the quality of goods come up to their requirements, would be another way by means of which a large amount of capital would be available for industrial purposes.[35] The Government spends its sterling resources for the securing of these stores in England and if indigenous goods of equal standard with the foreign manufactured goods are to be had the Government should be in a position to make the purchases here alone. The following table shows the imports of Government stores.[36]

[35] The organisation of the Stores Purchase Department has been expanded and agencies have been established in various important countries. The important departmonts of the Central Government and some of the Provincial Governments purchase stores through this agency. Engineering and selected manufactures and textile goods are being bought through this agency. In 1924-25 goods worth 259 lakhs of rupees were purchased in India.

[36] For details of recent years see the Review of the Trade of India under the heading "Government Stores."

(In thousands of Sterling).

	1909-10—1913-14.	1914-15—1918-19.	1919-20.
Metals	414	946	1,667
Railway Plant ...	1,864	883	4,462
Wool manufactures ...	...	751	690
Arms, etc.	162	704	1,044
Apparel	...	475	422
Hardware	197	430	870
Cotton manufactures ...	...	342	297
Flax	...	291	297
Instruments, etc. ...	121	252	419
Parts of ships ...	...	185	20
Machinery ...	187	182	447
Chemicals ...	...	149	111
Stationery ...	64	148	271
Telegraph material ...	78	120	579
Drugs, etc. ...	...	101	201
Coals, etc. ...	101	27	1
Other articles ...	672	1,698	1,933
TOTAL ...	3,880	7,634	13,731

The accumulation of capital.

The capital resources of the Indian people have been increasing both in utility and volume and the following table shows the number

of companies at work.[37] The capacity of the Indian capital market is slowly expanding. The extent of the resources available in the Indian capital market is estimated at or near 200 crores. If the hoarded monetary property were to be liquefied and invested in Government property, industrial debentures and land mortgage debentures, the economic progress of the country would be accelerated. The advent of foreign capital would cheapen the financial resources in the capital market.

But it cannot be accurately ascertained how much of this capital is Indian-owned. As a broad generalisation it can safely be stated that it would amount to 1/3 of the total amount. It is not in the form of the paid-up capital of the joint-stock companies alone that foreign capital enters India.

The different forms in which external capital enters India.

Human as well as material capital enters India. One thing which escapes the calculation entered into under Indian imports is the fact "that young men are imported and their ability and energy are an advantage to India. England bears all the costs of their nurture and education ; while India however reaps the benefit out of this expenditure."[38] India counts all material goods under her exports to

[37]

Year.	No. of Companies at work.	Paid-up Capital.	Increase or decrease in paid-up capital.
1900-01	1,366	369	...
1901-02	1,405	325	3·8
1902-03	1,440	380	1·7
1903-04	1,488	387	1·7
1904-05	1,550	403	4·0
1909-10	2,216	614	7·8
1915-16	2,476	850	5·2
1920-21	4,708	1,614	33·5
1921-22	5,189	2,305	40·2

For recent statistics see the Annual Report of the Registrar of Joint Stock Companies.

[38] See Dr. A. Marshall, "Money, Trade and Commerce," p. 135.

England. Although this seems to be an ingenious defence of the economic drain theory one thing has to be remembered. If these skilled imported men make India their land of permanent abode instead of treating it as a " land of regrets " and teach the Indians to acquire their skill and industrial efficiency, the prosperity of the country would further increase. In the case of the U. S. A. it was the skill of the immigrants in farming, forestry, and mining that contributed a good deal towards the industrial development of the country. Material capital enters India generally in the following ways: (*a*) Subscriptions to Government loans and the loans of quasi-public bodies such as Municipalities, Port Trusts, Improvement Trusts. (*b*) As capital of the joint-stock companies with sterling capital or as debentures of the rupee joint-stock companies when raised in the foreign country. (*c*) As the capital of the private businessmen. (*d*) As banking capital imported by banks during the busy season.

Estimate of External Capital.

It is not British capital alone that is invested in India. The Japanese, the French, and the American capitalists have also invested to a certain extent in this country. Various estimates have however been made now and then to ascertain the amount of British capital invested in India. Before noting the different estimates it is advisable to understand the means by which British capital has been able to obtain a dominating hold over the industrial situation. Mr. C. K. Hobson points out that some amount of capital was exported to India before the 17th and 18th centuries. European relations with India at this time present a flagrant example of the exploitative tendency of capital in the worst possible manner. San Thome is a blot on European civilisation. " By the middle of XIXth Century England began to supply the greater part of the locomotives, steel, iron, timber, etc., for railways in India. At present it owns the bulk of the Indian Railway Companies' 'foreign issues.' A large part of the Indian Government stores imported by the sea is chiefly supplied by the British industrialists even now. Towards the close of the XIXth Century British capital was driven by the American capital from the New World and was squeezed by the European financial mechanisms,

hence it began to push its way to India, to Australia, to Africa, to South Africa and other undeveloped parts of the Empire. At present hundreds of millions of pounds (1,500 millions according to Hobson) of the British investors' money has been poured into this country in order to provide it with railways, irrigation works, to build barracks and forts, to set up gun factories, cotton mills, jute mills, mining and trading enterprises and different industries.[37] With the exception of cotton mills of Western India the keys of all the vital businesses of the country are in their hands. The banking system as a whole is practically their creation. The indigo business is gone. The business of the breweries is languishing. The coffee planting of South India might receive a set-back but they are more than compensated by increased scope in coal and tea business. Owing to enormous growth in population the movement of exports and imports with their numerous ramifications has given scope for the development of the retail trade which is again in the hands of the British capitalists. It is not uncommon to find an importer of Calcutta ready to deal with claret, whisky, electric light establishment, printing business, etc. These European tradesmen, or non-official Europeans as they are known generally, form a potent and transforming energy working for material progress and enterprise but the retention of industrial and commercial profits in this country would augment the capital available for further industrialisation.

Varying Estimates of Foreign Capital.

It is impossible to ascertain with any degree of accuracy the amount of foreign capital employed in India. The first comprehensive

[37] Mr. G. F. Shirras estimates that the profits of the Bengal jute mills during 4½ years amounted to Rs. 31,000,000. As regards the interest that India pays it has been estimated that about 60 crores of rupees would be the annual payment. According to Prof. K. T. Shah 219 crores of rupees goes out as payments to the services rendered to India. See Prof. Shah and Khambatta, "Wealth and Taxable Capacity," p. 234. Such estimates as these can only indicate the actual direction of the flow of profits and so far as the quantitative estimate is concerned, it is valueless.

attempt to calculate the amount of foreign capital was made by Sir G. Paish in 1911. The following table shows the different estimates:—

Author.	Year of Estimation.	Where estimated.	Amount. £
Sir G. Paish	1911	Paper before the R. S. Society.	365,100 000
The Economist	1911	"Our Investments Abroad." Economist (20th Feb.).	470,000,000
H. F. Howard	1911	India and the Gold Standard.	450,000,000
One witness before the Chamberlain Commission	1913	—	400,000,000
Sir G. Paish	1916	The New Yellow Peril by B. Mukherji.	390,000,000
Sir D. Sassoon	—	—	420,000,000
Sir A. Birkmyre	1917	—	500,000,000
Sir L. Abrahams	1919	Evidence before the Currency Committee, 1919.	450,000,000
The Financial Times	1930	Sayer's article	600,000,000
G. D. Birla	1932	The Economic Journal.	1,000,000,000
G. F. Shirras	1932	The Economic Journal	481,000,000 to 500,000,000
A more recent estimate	1933	,,	575,000,000
My estimate	1933	India Analysed, Vol. III	612,000,000

The task of ascertaining this amount is beset with difficulties, inasmuch as the calculations are more or less in the nature of a guess-work. As these estimates are a matter of conjecture it is not wise to give currency to the details of their calculations.

Whatever might be the exact figure of the foreign investments in India nobody denies that with the exception of the cotton business of Bombay the keys of all the vital businesses of the country are in their hands. In addition to capitalistic agriculture, *i.e.*, jute and tea,

coal-mining, gold-mining, shipping, the promotion of feeder lines for railways, electric light supply schemes and the banking business are solely in their hands.

Why Economists object to Foreign Capital.

Woodrow Wilson says, a country is owned and dominated by the capital that is invested in it. In proportion as foreign capital comes in among you it takes its hold and therefore the processes of capital are in actual sense the processes of conquest.[38] The late Mr. Ranade pointed out this fact long ago and remarked as follows: the political domination of one country by another attracts far more attention than the more formidable though more unfelt domination, which the capital, enterprise and skill of one country exercise over the trade and manufactures of another. This latter domination has an insidious influence which paralyses the springs of all the various activities which together make up the life of a nation.[39] Prof. Scott says that "the compulsory economic dependence of foreign capital and economic subserviency is a more subtle evil than political subserviency." [40]

At least the key and vital industries of military importance should be kept from outside control. Considerations of national integrity require that Indian trade, commerce and finance must be under their control.[41] It is a sad and poor compliment to the rich Indian landlords, Marwaris, bankers and indigenous capitalists to allow the foreigners to work out our industrial resources. Inefficiency and supineness have given scope to foreign capitalists to worm themselves quite into our economic vitals to the extent of menacing the political future of our people.[42] Economic preponderance and financial conquest, assured for a number of generations, have inevitably given them the political domination. They have created vested interests for themselves. In their anxiety to save these interests they stand opposed to all political

38 See Woodrow Wilson, "International Ideals," I, p. 78.

39 See also Dr. C. K. Hobson, "Export of Capital," Chs. XIV and XXX.

40 See M. G. Ranade, "Essays in Indian Economics," Second Edn, p. 105.

41 See W. R. Scott, "Economic Problems of the Peace after the War," p. 27.

42 Under this heading should be included Industrial enterprises like iron coal and textiles, and agricultural industry, banking, shipping, mining and metallurgy.

parties on the mistaken notion that a national policy might sweep away their interests [43]

Why foreign capital is objected to by Indian people ?

The present attitude of the Indian people towards foreign capital can be described in the language of Dr. Grunjel. " It is only in the early stages of capitalistic production that foreign investors' capital will be viewed by a country as desirable. As soon as the spirit of enterprise becomes active in the country itself attempts will not be wanting to replace such capital by foreign loan capital which leaves in the possession of the debtor country the excess of its earnings above interest, thus operating to enrich the latter more rapidly and at the same time eliminating the unavoidable personal influence of the foreign capitalist on the domestic economic policy. The most insistent opposition to the foreign enterpriser will be found in the case of those enterprises to which is entrusted the safeguarding of any special economic interest of the community in the field of national defence, of trade, industry and commercial policy."

The first protest against the exclusive domination and sway of the foreign capitalists came from the late Mr. G. V. Joshi [44] in connection with the extension of railways solely with the help of foreign capital. The late Sir V. D. Thackersey attacked the employment of foreign capital in the most scathing terms as follows:—" But when we turn to the petroleum industry in Burma, the gold mines of Mysore, the coal mines of Bengal, the tea and jute industries of N. E. India, the carrying trade by sea and the financing of our vast foreign trade by foreign banks we come upon a less favourable aspect of the question of the investment of the foreign capital. In such cases we cannot but think that it would be to the permanent good of the country to allow petroleum to remain underground and gold to rest in the bowels of the earth, until the gradual regeneration of the country, which must

43 I use " vested interests " in the sense that T. Veblen has given to it. As he says, " vested interests are prescriptive interests or rights to get something for nothing." As an example the action of the Indian Exchange Banks might be quoted. See chapter on the " Exchange Banks."

44 See Speeches and Writings, p. 688.

come under the British Rule, enables her own industrialists to raise them and get the profits of the industries. The price paid is much too great for the advantage accruing from them to the country." [45] Sir T. Holland openly resented the exploiting of the petroleum resources of Burma and remarked that "the drain of profits is an unnecessary and undesirable tax which India must continue to pay until she could find her own capital." [46] Sir Sankaran Nair in one of his Minutes of Dissent says, "we know that there are trade commissioners whose business it is to find out the natural resources and facilities for trade—English trade in particular—that exists in our country. The results of this observation are to be made the basis of expert advice as to the best mode of utilising their resources in the interests of the English trade. It is true that this information would be equally available to the Indian public but we know it is the commercial organisations in England that would be able to utilise them." [47] Mr. B. C. Pal writes that the British Government in India though wedded ostensibly to the pernicious doctrine of *laissez-faire* was really helping the British capitalists in their attempt to exploit Indian resources successfully by giving these facilities through the administration of land laws and railroad construction, granting or securing mining leases that have been subject to Government sanction and favourable land laws as in the case of the Assam Tea Industry.[48] The way in which the indigo planters of Bengal and Behar and Orissa secured official help is too well-known to need any repetition. The imposition of the cotton excise duty, the partial manner in which the waggons were distributed during the recent war and the way in which the Government officials are allowed to resign and join foreign private firms and supply information and knowledge supplied to the Government by the firms all over the country and lastly the way in which the Imperial Government used to subsidise the foreign papers

[45] See the Presidential Address at the 2nd International Conference, 1906.

[46] See the Report of the First International Conference, 1905.

[47] See the Government of India's Despatch on Reform proposals, March 5, 1919.

[48] Indian enterprises used to find difficulty in acquiring land in Bengal. The land laws and the revenue regulations which affect the Board of Transfer of Land Rights work in practice to the prejudice of the Indian enterprises. It must be recognised that this situation has been improved by the I. I. Commission.

and refused to punish the Anglo-Indian papers even when they insulted it, are some of the flagrant examples of the way in which the foreign [49] capitalists have been unduly favoured in this country in the past. Prof. Shah observes that " under the present unfortunate circumstances of India the foreign capitalist is able to command the mystic sympathy of the identity in race even when he cannot boast of a more obvious relationship ; he has been able to obtain information and concessions which place him in a position of advantage when compared with his Indian confreres in business or industry. Once entrenched in business or industry he is apt to regard his position and privileges as his property....The conquest and annexation of Burma were planned and achieved largely if not entirely with a view to facilitate the foreign capitalists in exploiting the petroleum resources of that country. This however is not a solitary instance of *la haute politique* in India being manoeuvred in favour of the foreign element and dead against the Indian interests as the history of our currency organisation can testify." [50] Several of the witnesses before the Indian Fiscal Commission spoke disparagingly of the foreign capitalists. It is not the educated capitalists alone that resent the instrusion of the foreign capitalists but the educated class and the politically minded nationalists are jealous of the influence of the foreign capitalists. Specially the way in which they have opposed all political progress at

49 The Assam Cooly Act which was in force till 1881 was designated by the late Kristodas Pal as the Assam Slave Act.

See also Buckland, " Bengal under Lieutenant-Governors " and Misra, " Indigo Disturbances. " See Sir Sankaran Nair's Minutes of Dissent to the Reforms Despatch, 1919, as regards the cultivators' distress in the Champaran District.

There was a prosecution of people who stirred up labour in Madras under the Defence of India Act on the plea that industrial agitation has been threatening public peace. This, says Mr. Wadia, was due to the suggestion of the Buckingham and Karnatic Mills engaged in war-work. See " Labour in Madras. " Another writer says, " the attitude of the Indian Government towards labour is not entirely impartial. It has not only openly sided with the employers in supplying them with troops to preserve peace in times of industrial dispute but also to coerce and intimidate the labourers into submission." He instances the example of the Madras Government lending 50 members of the Labour Corps to the Electric Supply Corporation to carry on the work and starve the labourers into submission. Mr. Shah says, " Capitalist class consciousness is already apparent and Govt. seems to lead the way in its intensification if we are to judge from the methods adopted in crushing the postal strikes of 1920-21 in Bombay—Trade, Transport and Tariff, p. 179.

50 See K. T. Shah, " Trade, Transport and Tariffs."

the time of the Ilbert Bill[51] and the resentment at the grant of reforms outlined by the Montford Scheme has alienated the sympathy of the educated class.

The Example of the Western Countries.

In Roumania, Chile and Greece attempts are made to exclude the foreign capitalists in their vital national industries.[52] In the case of Switzerland every foreign Insurance Company must appoint an agent general who must be a Swiss citizen and actually reside in Switzerland. By the law passed in August 16, 1919, every foreign insurance company must make deposits in cash and if in securities one fourth must be in foreign bonds. Italy encourages the entry of foreign capital into the country. Italian companies are allowed to float their debenture bonds in foreign countries. The general opinion in the country favours the contracts-cum-loan idea, *i.e.*, foreign companies obtaining contract for construction on a large scale should provide the requisite capital which is required by certain guarantees of payment of interest and repayment of capital spread over a number of years.[53]

Even England has scented the dangers of the foreign capitalists' domination over the industries of the country. Many of the witnesses before the Wrenbury Committee of the Board of Trade favoured legislation limiting the portion of capital which aliens may be allowed to hold in joint-stock companies. This committee has recommended that no restrictions should be placed aginst foreign capital entering into England for the following reasons. England can never hope to be the world's financial centre in the absence of this valuable privilege encouraging the free flow of capital into England. Secondly, political differences would arise between the allies and England if the latter were to close its doors against the entry of their capital. Thirdly, it would result in encumbering trade with heavy pitfalls and meaningless restrictions and technicalities. Fourthly, foreign capital

51 See Sir H. Cotton, "New India." The Anglo-Indian agitation against the Ilbert Bill gave rise to a counter-agitation of first-rate importance on the part of the nationalist. They have learned the strength, the power, of combination and the force of numbers.

52 See Dr. Grunzel, "Economic Protectionism."

53 See the Report of the Department of the Overseas Trade, p. 39, Dec., 1922.

must be given free access into the country except in a very few instances. On the other hand, there is the advantage of holding this amount of foreign capital as security for England's investments in those countries. By virtue of the Merchants' Shipping Act of 1894 no alien is entitled to hold any share or become a part proprietor of a British ship.

The Example of the Eastern Countries.

At first the Chinese Government relied entirely on foreign loans, But towards the end of the Manchu regime a series of domestic loans were issued but the public did not respond cheerfully.[54] The first domestic loan that was fairly subscribed was that of the year of the Republic (1914). In fact this issue was oversubscribed. Since then every year a new loan has been floated varying from 5,000,000 to 48,000,000 Gold Dollars. More and more the Government has been depending on the native capitalists but as the best security has been already set aside for the Boxer Indemnity and the foreign loans it is difficult to make the native capitalists subscribe to these loans. But since 1921 no large foreign loan has been floated. At present no foreign capitalist can secure any interest in mining companies. Except the technical staff no foreigners shall be employed. For the former the contract must be signed by the ministry of Agriculture and Commerce. No ore-selling contract made with the foreigners shall be valid without first obtaining sanction of the same ministry. The latter has the option in buying the output. In Japan the alien capitalist domination is limited to narrow limits.

The Practice of the Colonies and Dominions.

Some of the Colonies and Dominions as Australia, Canada and South Africa float internal loans and the Governor of the Australian Commonwealth Bank of Australia remarks as follows:—" Australia's

[54] See the Year Book of China (1922), p. 133. In the case of the Shantung coal mines it is agreed that Japanese capital ought not to be more than half. In the case of salt and other industries where Japanese nationals were working the Chinese Government has agreed to buy them over (pp. 1172-73).

internal borrowing policy has proved the measure of laying in Australia many millions of money which would otherwise have been sent out of the country." But if her demand for money is urgent she has no objection to float loans in the London money market. Owing to the congestion of the investment market she has been advised to float the balance of her recent loan in New York. Out of the loan of £20,000,000 floated in July in 1925 only £5,000,000 were subscribed in London, the rest could be secured in New York. Although the Commission charges were a little higher than in the case of London and although the rate of interest to be paid is somewhat higher, the loan could be easily floated in a few days. While the net price that could be secured in London was about £96-3*s*. only £96 could be secured in New York. One compensating feature however is the absence of the stamp duty in New York. In London interest of £5-4*s*-4*d*. per cent. has to be paid ; while in New York the net annual interest it has to pay is £5-4*s*-10*d*. per cent. But the chief noticeable fact is the willingness of the American investors to subscribe to Government loans floated by the European countries and the Dominion countries of the British Empire. About 551,591,000 dollars were publicly subscribed in the first half of 1924 (Banker's credits excluded).[55] The Australian Commonwealth Bureau of Commerce and Industries remarks that "The Government is anxious to encourage and facilitate in every way the transference of British manufacturing concerns to this country." The same can be said to be the attitude of New Zealand and South Africa. The concessions granted are usually in the form of local monopolies, grant of land, etc., but not much in taxes. Money is needed urgently for the development of their national wealth. Hence their cry for men, money and markets. The present-day economic thought is to bring about a better distribution of the White race in the British Commonwealth than before. All available capital is to aid this process of migration on the part of men from Britain and thus incidentally solve the twin problems of increasing population and increasing unemployment. The furnishing of men, money and markets is the duty that Great Britain

55 See the Washington Correspondent of the Exchange Telegraph Co., July 19, 1925, quoted in the "Forward," August 16, 1926.

owes to the Empire countries and if this were to be successfully solved there would be all-round prosperity for all parts of the Empire. Secure of the food supplies and the raw materials for her industries Great Britain would be free to concentrate her attention on manufactures and regain the lost industrial supremacy which she once enjoyed as the "workshop of the world." Canada places no restrictions against the entry of foreign capital. There are about 675 branches of American factories in Canada doing business in carpet-making, steel springs, glass and brush-manufacture. While Canada admits freely the foreign capitalists the Dominion of Australia has recently passed the War Precautions Repeal Act and Section 8 of this Act says: "no company in which more than one-third of the shares are held by aliens shall acquire any mine or interest in a mine or carry on mining or metallurgical industries." Again it is laid down that "no alien can acquire any share in any company incorporated in the Commonwealth without any express consent in writing of the Commonwealth Treasurer."

The Necessity for Capital in India.

India's mineral resources largely await development.[56] With the exception of coal, iron and gold, the other minerals have not been sufficiently developed. The possibilities of developing the forest wealth are very great. Even agriculture requires further development. Capital is necessary for all these purposes. India is an old country and for several centuries her people have been poor. The fertility of her soil is far below that of the advanced countries. Her population is still predominantly agricultural. They have been noted for their conservatism, lack of enterprise and the unprogressive character of their industrial development. Centuries of isolated and self-sufficient life

[56] See A. Demangeon, "The British Empire," p. 220. See also the London Times, May 24, 1926. One noticeable peculiarity in Canada is this. Five-sixths of the English capital seek Government securities and nine-tenths of the American capital is invested in industrial enterprises. There is also some penetration of American customs and civilisations from the United States of America into Canada. For the present situation, see special article, "Canada To-day." The American Invasion, Dec 5, 1927, p. 15 (The London Times). For still more recent figures, "Economic Planning of Canada" published by the League for Social Reconstruction, can be consulted.

have taken away the incentive to work and earn more. The nature of the social institutions places so many obstacles in the case of progress that India can well-nigh be considered as the " land of impossible limitations."

The Indian Industrial Commission remarks: " the wealth actually possessed does a very small amount of work owing to its inactivity. The difficulty of raising capital for industries is mainly the measure in India not of its insufficiency or inaccessibility of money but of the opinion which its possessors hold of the industrial propositions put before them." [57] Thus the chief reason is the imperfect confidence on the part of the small capitalists of India There is no sustained confidence and it is this that stands in the way of rapid development of banking and leads to incipient runs on the existing banks. It is this that must explain the inability on the part of our industrialists to obtain the necessary capital.

The spirit of enterprise is slowly becoming active in this country. Hence the desire is to replace *entrepreneur's capital for the loan capital* and to retain in this country itself the excess of its earnings above interest. There is a desire to avoid the undesirable personal influence of the foreign capitalist on the domestic policy. Their pride of colour, and assumption of arrogant superiority, policy of domination and exclusion and general moral aloofness is irritating and galling to the Indian educated mind. They insist on employing their own officers, engineers and workmen and rarely accord fair, equal and

[57] See the Indian Industrial Commission Report, paras. 55 and 56. Tungsten can be successfully worked in Burma. Chota Nagpur is a wonderfully mineralised country. Copper, manganese, iron, lead, chrome ore, bauxite, mica, graphite, stealite, silica, lime and ochres and wonderful deposits of coal of economic importance are known to exist. Owing to the lack of education in the right prospecting methods these resources are not yet opened up. No mining school has been started there to impart the characteristics of minerals, their constituents, field tests and a proper understanding of the earth's crust. There has been no chamber of mines drawing attention to the state and condition of mining. Next to agriculture mining is bound to be the greatest industry of India. But upon this broad foundation of material progress the people have to build up their thrift and enterprise. The possibilities of cocoanut and bamboo industry are very great. The Government has hitherto neglected to take stock of the industrial possibilities. Its duty is to test, to explore and to prove the possibilities of industrial success and exhort the Indian capitalist to overcome their rooted indifference to industrial enterprise. See also the Report of the I. I. Commission, para. 49.

impartial treatment to Indians. Foreign capitalists [58] have settled already to a great extent and indigenous intelligence and skill must take them as their objective models for imitation. The educative value of their presence must not be lost unnecessarily. But if more foreign capitalists were to start branch factories in India as suggested by Mr. T. M. Ainscough it would not help the industrial situation to any marked extent. More riches would flow out of the country and the ultimate benefit which India would derive from these able foreign industrialists would be, as Mr. Chatterton says, " to earn more wages in subordinate positions by doing coolie work." [59]

A distinction has to be drawn between entrepreneur capital and loan capital.[60] The free flow of loan capital has to be encouraged. When Indian capitalists are already working in the field, permission must be granted to have access to the London Money Market and float debentures there for augmenting their capital resources. Foreign capital has to seek the co-operation of the Indian investing public and be prepared to assist it with all possible help. While the total requirements for capital are huge, the capital that can be immediately mobilised in India is small. It would be a suicidal policy to postpone the effective working of those resources by shutting out foreign capital from India.[61] India has to establish contact with the International Market for the rapid promotion of her public works, specially those of a

58 See the Report of the Bombay Committee on the Rehabilitation of Government Securities.

59 See A. Chatterton, " Notes on Industrial Work of India."

60 This is the considered opinion of Mr. Tuke of the Barclay's Bank and a member of the Acworth Committee on Railways—Report of the Acworth Committee, p. 69.

61 Joint-stock companies of non-Indian origin doing business in India in the different lines are as follows (1920-21). See the Statistical Abstract for British India, pp. 579-80. For recent figures consult this annual publication.

	Paid-up Capital Rs.
Industrial Companies	54,98,96,256
Banking and Insurance Companies	19,56,21,552
Trading Companies	44,67,47,165
TOTAL ...	1,19,29,73,933

Indians might be holding shares in these companies and their share might amount to ⅓. Again there are companies that are started elsewhere but doing business in India. They number 678 and their paid-up capital is £501,613,574.

reproductive nature. The proportion of revenue-earning capital in India is greater than the proportion of non-revenue-earning capital. Hence it would not be difficult for the Indian Government to find a market for its loans if it wishes to pay the market price.

It is not wise to discourage the free flow of British capital and place obstacles in the way of British enterprise but it is important to remember that ' the sub-conscious promptings of nationhood " should not be hurt. This is one of the important problems, says Lord Ronaldshay.[62] The changed attitude of the publicists, economists and the people would have to be noted by the foreign capitalists as well as the Government of India. As the late Dr. Naoroji pointed out long ago: " India sorely needs the aid of English capital, but it is *English Capital* she needs and not the *English invasion* to come also and eat up both capital and produce." [63] Foreign industrial or trade companies might be forced to adopt a proportional representation of Indian Directors on the Board. Those companies that fail to comply with these regulations ought to be taxed at a heavier rate than the other companies. A heavy licensing fee should be charged in the beginning as is done in the case of those banking companies which wish to appoint an agency of their own in New York. For this privilege a foreign corporation has to pay a licensing fee of 250 dollars annually to the Superintendent of the State Banking Department. It should also satisfy him as regards its financial stability and its power to open an agency under its foreign franchise. It must make certain returns in accordance with the provision of Section 147 of the Banking Law of New York.

Measures for the development of capital resources in India.

It has been suggested that foreign capital might be allowed to flow freely into India but that it should seek the co-operation of the Indian investing public and be prepared to assist it with all possible help. The ultimate object must of course be to enable the Indian capitalists to become the natural heirs of foreign enterprise in this

[62] See Lord Ronaldshay, " A Bird's-eye View of India."

[63] Dr. Naoroji, ' Poverty and Un-British Rule in India," p. 229. See also G. K. Gokhale's " Speeches," March 9, 1911, I. L. Council Proceedings.

country. For this purpose the investment habit has to be stimulated. Other means to encourage the increase of capital resources have to be simultaneously undertaken so as to augment the stream of capital that awaits profitable work for itself.

(A) The most unfortunate thing about India is that it is not organised socially and economically so as to secure the maximum accumulation of capital. The Indian caste system is neither "a purely economic organisation of occupations nor a chaos of tribes and conflicting races, nor a simple hierarchy of classes, but a mixture of all those unified by the common inspiration which dominates all the groups in their functioning." [64] Birth once for all determines the social status of an individual in the Indian society. Some of these people either by the favour of fortune or by the dint of their intellect may succeed in "breaking their birth's invidious bar and breast the blows of circumstances and grasp the skirts of happy chance." They may grow rich but the inequality of status is a thing that would be never removed. There is no social ladder existing in the present condition of society.[65] Our social organisation is wholly composed of restrictions, privileges and monopolies. Our women and girls are incapable of realising the evils besetting the social structure. Early marriages, ill-assorted marriages, child-widows and uneducated motherhood still exist in our society. The Indian nation uses only one-half of its citizens, *i.e.*, the males, for social, economical and public service. Hence it is weak as well as poor when compared wih other countries. Caste, joint-family system, the depressed classes and the inferior position of women are the strongholds of orthodoxy. The philosophy of *varnasramadharma* is supposed to be the basis of our social theory and organisation but it does not actually fit in with present-day facts of our society. This meaningless shibboleth of the dead past should be given up. The mere accident of birth ought not to have such a powerful influence on the individual's life. The rigidity of social framework placing impediments in the path of individual progress has to be toned down. The benumbing influence of pantheistic views of the world, a supersubtle metaphysic and a stagnant civilisation limit the individual's scope to better himself. The creation of a social

64 Senart, "Les Castes Dansle Inde," p. 258.

65 See William McDougall, "National Welfare and Decay," pp. 155-57.

environment, however hard it might be, has to be undertaken. Social evolution or reform is vitally interrelated with the question of national efficiency and national solidarity. It would, first of all, make great demands on national or public purse which would fructify in the long run by increasing the productive forces of the country as these agents become more progressive, energetic and intelligent than in the past. An increase in the objective wealth they produce would enable them to save more. At present the greater portion of the Indian people are producing just enough to live on and unless they increase their savings no further social progress would be realised by them. The actual money paid in wages must be higher than the general living expenses of the country. This would enable the people of the country to educate themselves and every step in " the direction of perfecting the democratic organisation of society or everything that throws open the world to talent, that finds the right man for the right hole—educational facilities, scholarships, personal agencies—all such things as contribute to the perfection of the social ladder by which the ascent of merit and the decent of ineptitude are made easy " has to be welcomed.

(B) The Indian Government or the Board of National Investment had to act as a guide to the investors by compiling reliable information and publishing it for educational purposes. This would suggest the useful investments,[66] which people can take up and benefit themselves as well as the society. The state can in this way aid the saver and the society. Beyond the state and municipal bonds that are created the state does not concern itself with the other concerns. Of course the supervision, conduct and the creation of companies are subject to the control of the state, The Indian Government can do much more in the matter of protecting the ignorant investors from the dishonest

66 The French Government gives indications and uses the private investments of its capital-owning citizens to support national interests of a political character abroad. Thus the Government indirectly indicates the social value of the investments. The Stock Exchange is the only other body that does such a thing. There are only half-dozen stock exchanges in our country. It is not possible they can guide the investors as a body. In some cases capital is being invested in socially objectionable uses as maintaining brothels, adulterating goods and providing intoxicants The moral value of the use of capital has to be understood and the state alone can prohibit the non-moral or injurious use of capital, The Capitalists must not be given the right " to do what he likes with his own."

professionals by copying the principles embodied in the German Civil Law which prohibits the flotation of companies with shares of a lower face value than £10 from being floated. As Prof. Mitchell says, " the public regulation of the prospectuses of new companies, legislation supported by efficient administration against fraudulent promotion, more rigid requirements on the part of the stock exchanges regarding the securities admitted to official lists and more efficient agencies for giving information to investors—all these contribute towards diminishing the possibilities and narrow the range of error made by the incompetent investors." [67] The majority of the Indian investors are gullible simpletons, foolish, sheeplike, and lacking elementary notions as regards the difference between sound and fraudulent investments. The state would do well to include such subjects as money, savings, investments, and commercial arithmetic in the school curriculum. The importance of savings and its sound investment have to be rigorously preached. The state stands to gain by this wise direction of the channels of savings into permanent employment, affording working opportunities for its people. It would be an indirect method of attacking the unemployment problem in our society. Lack of requisite capital, lack of the right kind of education, lack of opportunity, ignorance where to apply for special work and the possibility of being offered a job in a trade—are some of the chief reasons why a great majority of the Indian population fail to develop their own personality or take real interest in the work they do. Mr. Gyln Barlow says, " the failures of the Indian industrial enterprises in the past are due solely to the fact that he (the Indian) has insufficient knowledge of his own industry and lacks intelligence, the shrewdness and enterprise that are necessary for a successful enterprise or business." [68]

All statistics relating to the business side of our national life have to be collected by the state and published so that the average chances afforded by every calling can be known very easily. This sort of action is nothing new. Many Governments adopt the policy of

[67] Prof. W. C. Mitchell, " Business Cycles, " p. 505. The Securities Act of President Roosevelt says the same thing. (1933 part of the N. Deal Campaign inaugurated by him for economic recovery.)

[68] See Gyln Barlow, " Industrial India," p. 32.

supplying information to the labour exchanges free of charge. The Canadian Government realising the importance of agriculture has established the principle of supplying information free of charge to any farmer on any matter relating to his business.[69] The object of making grants towards scientific research, instruction and experiment in agricultural science, says Pigou, follows the same lines.[70]

The aim underlying such action of these Governments can be expressed in Sir Horace Plunkett's words: "The purpose is to bring freely to the help of those whose life is passed in the quest of the field, the experience which belongs to wider opportunities of observation and a larger acquaintance with commercial and industrial affairs." [71] All callings have to be thoroughly studied, catalogued and a proper record established. Their mental, moral, and physical requirements have to be mentioned. This information would be of much value to children and parents. The expenses involved in this collection and publication of information would be very small but the state would be amply repaid as the people settle peacefully in the different callings best suited to their interests and inherent and acquired abilities.[72] Prof. Kirkaldy says, "in a well-organised society there would be a minimum of difficulty in deciding as to which labour group a man's special tastes and talents warrant his attaching himself to. Where mistakes are made it is evident that the community in question has not attained to the higher development and there is need presumably of modification and improvement in the system of education." [73] It needs no emphasis to say that the present state of Indian society is diametrically opposed to this ideal condition of society. There should

[69] See Mavore, "Report on the Canadian North-West," p. 36.

[70] See A. C. Pigou, "Economics of Welfare," p. 127. (2nd Edition.)

[71] Quoted in Sidney Webb's "Industrial Co-operation," p. 149.

[72] The Indian fathers generally set apart the fools of the family for industries and commerce. This is due to the fact that they do not possess sufficient knowledge as regards the lucrative character of these occupations. It is this that is responsible for our industrial backwardness and any industrial failure that may have been noticed. The inherent inferiority of the Indian brain for industrial and commercial business is a pure myth started by interested people. This weak point should be checked by setting the higher educated talents towards industrial pursuits. See Sir Dorab Tata's Presidential Address at the I. I. Conference. 1915, p. 19.

[73] See A. W. Kirkaldy, "Wealth," p. 73.

be a system in the matter of investment as in every other walk of life.[74] If the above information is made known the existing unwillingness on the part of the savers to invest their savings would be overcome. The average requirements of the entire community can thus be grasped. Until this is known there would not be much co-ordination between the savers and the users of capital.[75] This is the only road that leads to increased savings, wiser investments, greater comforts, security of employment to labour and ultimate well-being of the nation. The existing owners of capital need not fear or fancy any real danger by this method of Government action. All savers of capital would be considerable gainers by this method. The insuperable difficulty of finding capital which limited the industrial development in the past, is slowly vanishing under the "influence of new ideas as a result of education, new banking facilities and a new enthusiasm for the employment of capital in industries." The carrying out of the above recommendations would accelerate the speed with which capital would be seeking employment in industries. It might also augment the volume of the industrial capital. Every facility has to be given to the small capitalists to obtain possession of shares of tea, jute, and coal companies. Small lots cannot be obtained and *bona fide* small investors do not really hold them. Unless this is facilitated no great development of the investment habit can be realised. Stricter laws in punishing directors, etc., who mismanage industrial companies are necessary. Wide advertisement of Government loans in the interior of the country at the time of floating the loans would make the mofussil people and small investors

[74] The policy in emigration is a haphazard and careless one. Its harmful results are to be seen in the sad plight of our people in Kenya and South Africa. See the Annual Register, 1922, p. 254. The recent attempts of the Hon'ble Mr. Srinivasa Sastri to better the situation of the workers are related here. Some minor disabilities have been removed. Certain disabilities hindering the Indian people to take up the banana industry were removed. The acquisition of land is to be permitted in South Australia and provision of old age pensions is extended to them by the Australian Commonwealth Government.

[75] Under the capitalistic system there is no such collection of facts. With no accurate idea of effective demand the producers engage in industrial work with the result that sometimes there is over-production of particular goods. This can be rectified by calculating effective demand in a crude form at least and trying to produce the things needed. Such collection of information was attempted by the Peruvian Incas in the hey-day of their glorious civilisation.

to invest in the loans. It is true that the people of the villages prefer to invest their savings in land and the "psychological" craving for land can only be equalled by their craving for jewellery. Land is bought recklessly at high prices though at best it can afford to yield only 6 % rate of interest. This has to be checked by the development of banking business in the interior.

Besides the above measures the Indian Government should aim at the development of the resources of the country in a manner worthy of the enlightened Governments like the U. S. A.[76] and the Japanese Governments. It is essential as individual inititive in the land is practically conspicuous by its absence. The peculiar circumstances in which India is placed owing to the lack of technical knowledge and lack of capital resources should be recognised. Foreign enterprise though not diffident in the matter of investment lacks the knowledge of the conditions of the country. Owing to these circumstances India has not rapidly become industrialised in spite of the lavish bounty of raw materials by nature. This situation reminds one of Mill's remark which runs as follows:—"In the many parts of the world the people can do nothing for themselves which requires large means and combined action all such things are left undone, unless done by the state." [77] Under these circumstances the Government has to step into the breach. It need not necessarily start all these possible industries which can be worked successfully in India. What is required is the change in the angle of vision by giving up its *laissez faire* policy towards industrial development in general. Co-operation and encouragement of the Government is necessary and, as the Madras Provincial Government has done, state-aid towards industries has to be systematised and the private enterprise should definitely know what it can expect from the Government.

The Government has taken the lead in all experiments for the improvement of agriculture. As the sole landlord of all India it has rightly come forward to study all problems connected with

76 President Roosevelt recently created the Tennessee Valley Authority as a Corporation clothed with all powers of a Government for the proper use, development, and conservation of natural resources of the Tennessee River drainage basin for the general and social welfare of the nation. See Commercial and Financial Chronicle, Vol. 136, pp. 3791-94.

77 See J. S. Mill, "Political Economy," Vol. II, 4th Edition, p. 575.

irrigation, forestry, fertilisation, breeding of cattle and improved agricultural machinery. It should also come forward, just as it has done in the Tavoy District of Burma, to encourage the successful tapping of mineral resources. A mere maintenance of well-equipped Geological Survey with experts in commercial aspects of Geological lore, is not sufficient. More research from the economic side has to be done. Modern civilisation is founded on mineral as well as agricultural resources. The Government's legislative policy, fiscal policy, mining regulations, forest rules and legal codes must all be planned, designed and worked with the supreme end of developing the resources of the country in the real interests of the country itself.

The Indian Government must no longer be guided by the views of the philosophical anarchists, who consider that there should be no Government at all ; nor by the Utopian socialists and communists who would like to transform all capitalist enterprise into an affair of the state ; nor by the ultra-individualists who would restrict and confine the economic functions of the state into a narrow circle. The individualistic assumptions of the old classical school as regards the state's functions have to be expanded to suit the circumstances of the particular conditions of the society. Competition, private property, and freedom of contract and the motives of business life as the starting point of an abstract and deductive science, have already been modified to a great extent. The psychological foundations and the humanitarian basis of economic life have to be admitted. The economic function of the state has expanded already since the recent War period. Collectivism has become the order of the day. It is not necessary for me to quote the various economic activities of the state during the War-time.[78]

[78] During the recent war the distribution of food and fuel was regulated by the State. The means of communication, transportation and shipping facilities were controlled by the State. Even the investment of private capital was supervised. The consumption of materials and supplies in non-essential industries was limited. The price of basic commodities was fixed. The excess profits of business-men was taken for national use. Serviceable young-men were forced to join the army. The Emergency Fleet Corporation, the Housing Corporation, the Grain Corporation, Sugar Corporation Board, the War Finance Corporation and the War Trade Board were specially created in the U. S. A. to perform the difficult economic activities effectively.

See W. F. Willoughby, " Governmental Organisation in War-time and After."

As Delisle Burns points out " neither would the State be organised as an economic community as the socialists point out nor would it be purely non-governmental organisation of industry as the Syndicalists and the new guildsmen like it to be, but there would be an unprecedented combination of the two.[79] The days of competitive capitalism have been almost numbered. The idea that the Government should " keep the ring and leave it to the producers to play the game " is no longer advocated by the economists. The individualistic system of production for profit instead of for the use and of distribution according to ability without any regard to human need is criticised by a host of writers.[80] The only criterion for state action is the promotion of the welfare of the people composing the state and western countries are tending to curb the evils of capitalism in several ways. Ramsay Muir says, Every Government is taking action to curb the gross inequalities of property by imposing heavy taxation, *i.e.*, death duties which restrict the amount of capital that may be handed down from generation to generation by inheritance by a system of graduated taxation that takes more from the rich than from the poor by the levy of excess profits and on the other hand by the offering of banking facilities for the man of modest means, by the encouragement of co-operative production and by investing on industrial companies offering facilities for investment by the workers.[81] Thus the function of the Government is no longer a negative one confining itself towards the maintenance of law and order but a positive thing tending to co-operate, constrain, direct and reconstruct where economic conditions fail to right themselves.[82]

Even J. S. Mill who always had *laissez faire* philosophy as the basis in his thinking admits that there is a multitude of cases in which

[79] See C. Delisle Burns, " Government and Industry," p. 8.

[80] See R. H. Tawney, " The Sickness of Acquisitive Society;" also Sidney and B. Webb, " The Decay of Capitalist Civilisation;" Bertrand Russell, " The Prospects of Industrial Civilisation;" and C. H. Douglas, " Economic Democracy," pp. 58-74.

[81] See Ramsay Muir, " Liberalism and Industry," p. 44.

[82] See H. J. Laski, "Authority in the Modern State," pp. 81-98.

" The most striking change in the political organisation of the last half century is the rapidity with which by the sheer pressure of events the State has been driven to assum a positive character and in the main it is reasonably clear that political good is to-day for the most part defined in economic terms."

the Government with general approbation assume powers and execute functions for which no reason can be assigned except the simple one that they conduce to general convenience. Thus the effects are to be the supreme test of all Governmental action. If the welfare of the people can be realised by state action the state might tend to perform those actions. The ethical philosophers go beyond this and point out that human welfare is an ethical end and every one ought to have an equal opportunity of achieving personal well-being. The duty of the state according to them is to equalise opportunities for all. " Happiness for all has to be justly meted out." This is the real meaning of economic moralism and the object of every state is to secure the moralised economic system.[83]

The relativity of economic function to the State has to be understood. The individualism of the India Government does not fit in with the actual facts of the day. If the people composing the state are not advanced well in the art of production, it is incumbent upon the state to recognise the shortcomings of the people and make amends for it by its own compensatory action. Until then the general welfare of the people would not be secured. Private and special interests would be benefited. Private people tend to be guided by pure selfishness and greed and it is hard to expect that they would coincide with public good even supposing that their actions are prompted by altruistic motives.[84] At this point the question becomes purely political and it would be beyond the scope of our subject to discuss it.

Recent economic thought is to consider " industry as a social function"—Labour, capital and the consumer are partners and equals co-operating with one another in this service.[85] The India Government must realise this and guard against the development of capitalism

83 " Economic moralism means public ownership and management of all the means of production, the public supply by production and change of the requirements of the community, namely, food, shelter, and all other articles and services required by individual members of the community, the co-ordination of all economic activities for the general or national good and the abolition of all unearned income except to the incapacitated, the remuneration of all the workers being mainly in proportion to their diligence.

84 See Haldane Smith, "Economic Moralism," p. 99. See H. S. Hobhouse, The Elements of Social Justice, p. 30 : "of collective achievements as of collective aims it holds good that its value is to be tested by its bearing on the actual lives of men and women."

85 See "Capital and Labour after the War," edited by S. J. Chapman—Articles 5 and 6 by R. H. Tawney and Seebohm Rowntree. See also the report of the Whitley Committee

of the Western type. Karl Marx was entirely wrong in his assumption that " no country unless it passes through the capitalistic mill can make its proletariat enjoy everything as its own." Wisdom and foresight should be exercised in this matter and the development of co-operative production can go far in remedying the situation. The Indian Government ought to undertake fresh enterprises and Indianise the foreign industries existing in our country.[86]

In the language of Dr. Marshall " India is developing renewed vigour and independence in industries as in thought.[87] The rapid recent rise of her larger industries is a source of just pride to her and of gladness to Britain. The India Government is also slowly reforming itself, adapting itself to modern conditions, abandoning " its pseudo-liberal policy of drift, neglect and mammonism, miscalled non-interference, individualism and free-trade." India has definitely embarked on a system of discriminating protection with a view to develop those industries which she can easily set up. But capital is needed to develop these and now that free trade principles need no longer be acting as a drag [88] indigenous capital will certainly come forward provided there is confidence in the ability, integrity and honesty of purpose of the industrialists. Soundness and safety are the principles which appeal to the Indian investors. The enormous sums invested in Government loans afford another proof of the availability of capital. All the joint-stock companies floated in big cities or the Presidency towns by well-known captains of industry as directors and offering reasonable prospects of success have never failed for lack of capital. Hence, says Prof. Shah, " the myth of the shyness of Indian capital for industrial investment was manufactured for their own ends by those foreign capitalists who wanted to reserve the lucrative avenues of lavish Indian Government borrowing for themselves and there is no

86 This can be done by altering the Company law in such a way as to secure proportional representation of the Indian element in the directorate of the company. See Dr. P. N. Banerjea, India's Fiscal Policy, chapter on " Right Fiscal Policy."

87 See Dr. A. Marshall," Industry and Trade," p. 162.

88 See the Evidence of Mr. A. B. Shakespeare before the Indian Fiscal Commission. He says, " by adopting a policy of protection the difficulty in obtaining capital would largely disappear." The Minority Report of the I. F. Commission says the same thing. The lack of capital to which repeated references have been made is due more to the risks involved in establishing industries under Free Trade principles than the actual inadequacy of capital.

call upon us to give any unnecessary currency or credit to such interested libels on our people." "Money lies dormant in endless small hoards all over the country," says the Bombay Committee on the rehabilitation of the Government securities. But the chief desideratum is to organise our capital market.

The opening of the Stock Exchanges with their attendant paraphernalia for the rapid conversion of the scrip into money is essential. There are not even half a dozen Stock Exchanges for the whole of India. Control over the Stock Exchanges is not effective as in the case of the London Stock Exchange.[89] Unwise speculation in stocks and shares is very often to be noticed. The idea of a Government Stock Exchange has been mooted but this is no doubt the wrong remedy. The proposed legislation outlined by the Atlay Committee would go a long way in removing the malpractices of the speculators. The Calcutta Bhitar Bazar is a menace to legitimate trade and tends to produce unsteadiness and harm to business interests. A properly constituted stock and produce market where "futures" are allowed should displace the "gambler's arena." If worked on scientific principles and under proper administrative control, the recently organised Bombay Cotton Market would tend towards the benefit of the producer as well as consumer, by the steadying of prices, preventing of scares and establishing direct contact between the buyer and seller.[90] The employment of written stamped contract forms recognised by the Jute trade organisation and the enforcement of the delivery of produce mentioned in the contracts within a reasonable period

[89] See my article, Central Banks and Speculation for some suggestions for reorganising the practices of the Stock Exchange.

[90] Some misguided observers opine that future markets tend to increase fluctuations in prices. The Jute Mills Assn. considers that lower prices for Jute are due to the Jute Future Market. There is nothing so prejudicial as this opinion. The best expert opinion would welcome the existence of the Future Markets. No attempt should be made to suppress properly organised future markets. The International Chamber of Commerce, Paris, says that Future Markets minimise and smooth out price fluctuations, discount the impact on the market of forecasted supply and demand, correlate the world demand and supply, make a world price and keep it uniform, provide machinery for continuous trading and spread over a long period the burden of distribution of a short-period agricultural harvest.

and the fixing of a minimum quantity of Jute below which no transactions are to be permitted are essential to the jute market. Organised exchanges are essential and if wise " hedging " is resorted to all sections of the community would be benefited.[91] Such should be the nature of the different organised exchanges either in hessians, linseed or wheat or silver or any other stable commodity.[92] Unless such organised Stock and Produce Exchanges exist it is difficult to lend funds for capital purposes and keep the funds still in liquid state. Since these lines have been written a new stock exchange is being organised at Delhi. Commercial banks cannot lend for capital purposes in the absence of such stock exchanges where this liquidity of funds can be secured by selling the bonds or securities held as collateral for loans.

91 As in the case of Martin's law on the New York Stock Exchange the state must be empowered to investigate and prosecute officials possessing the swindling tendency. Mere licensing system would not cure the swindling evil. The Blue Sky Laws have proved a failure in the U.S.A. Perhaps the recent stiffening of the procedure by President Roosevelt would improve the situation.

92 It is gratifying to note that this advice has borne fruit. Sir H. S. Paul has recently opened the future market for jute transactions. The Calcutta Jute Exchange, Ltd., provides hedging facilities to the numerous loose jute dealers in Calcutta and to meet the needs of small dealers, 50 bales of jute has been adopted as its unit of transaction. The East India Jute Association has the unit of 250 bales and the bigger jute dealers alone can participate in its actual work.

CHAPTER XXIV.

The Investment Market.

Necessity for proper organisation—A National Board of Investment—Its methods—The Supervision of Investment Trusts—Municipal Savings Banks—Difficulties in their path—Premium Bonds—Instalment system of securring shares—The sale of Government securities—Development of other sources of capital.

Neccssity for proper organisation.

The necessity of directing the small investible savings of the Indian people into productive channels arises for combating the hoarding tendency on their part and is, really speaking, the financial facet of the same problem. As long as competent bodies or organisations do not exist to point out safe and suitable outlets at profitable rates of interest the investment of their savings cannot become an accomplished fact. They will continue to be hoarded thus greatly aggravating the difficulties of the industrialists and other borrowers needing capital for productive purposes. The opening up of new avocations by creating suitable rural industries, the converting of present-day extensive cultivation to an intensive exploitation of land, the revolutionising of the means of transport and rural communications, the re-organising on improved lines of the rural economy of the country, the rebuilding of most of the industrial towns and bigger cities according to recent standards of health and decency and the starting of new industries where there are possibilities of success, necessitate the investment of large capital. As the capital equipment of this country is not finished as yet it follows that every attempt should be made to mobilise the savings into great pools in the first instance and the safe investment of this accumulated capital on a large scale has to be brought about. It is high time that a concerted programme and united action for the development and perfection of the investment market should be drawn up. It is only by such a policy that economic well-being and national wealth can be augmented to any extent[1] and it would be the best

[1] See what the Report of the Bombay Committee on the rehabilitation of Government Securities says, paras. 28 and 29.

available method to counteract the vicious hoarding tendency on the part of the people and check the export of Indian capital abroad.[2] Of late capital is flowing from the Bombay-side into Europe and America in order to gain advantage of increased rates of interest which the dollar securities pay and the exemption of interest from taxation in the United States of America as well as from the country of origin and the assiduous publicity given to dollar securities in the Indian money markets.

A National Board of Investment.

As there can possibly be no end to the list of remunerative and useful developments [3] that can be undertaken, the other side of the shield, *i.e.*, the provision of financial resources, must be taken into consideration.[4] A Board of National Investment must be created to

[2] This movement took place during the recent war period when the depreciation of the Government securities, the low rate of interest offered as their yield and the absence of good non-speculative industrial securities, gave the capitalists scope and incentive to invest abroad and the appreciation of the rupee exchanges and rupee currency facilitated this outward expansion. The exact amount invested abroad cannot be exactly calculated as there is great secrecy in the matter of investments carried out under the aegis of the Indian banks. A rough guess is hazarded by a writer in the *Economist* (London) who estimates it at £37,500,000 or Rs. 50,00,00,000. This excludes the investments of the native princes. Another indirect advantage of developing the investment habit would be the increased use of cheques.

[3] Any amount of our national savings can be absorbed in building good roads and other durable goods needed for the development of our transportation industry. Building activities would absorb a large amount of capital, railroads, extension of telegraph, telephones, public utilities, electric power plants, agricultural machinery, and equipment of our holdings, extension of our industrialists' and businessmen's equipment need a large amount of capital. This picture in rough outline goes to show that our savings might not be sufficient to keep pace with the growing demand on the other side. Interest rates might not be on the decline until a certain amount of lubricating the capital mechanism can be done by our banking and credit structure.

[4] But *no accurate conception* of the real income *per head* has ever been estimated. The Government Reports constantly speak of the rise in the standard of living of the population. Is this secured at the expense of a substantial reduction in the volume of savings or is it the result of increase of *real income* per head ? What is the total amount of national savings in any year and how is it invested are some of the important economic problems. The Board of National Investment should attempt to make tentative estimates of these and suggest suitable methods for investing new capital in new lines of Indian industry or newer trades or modernisation of old ones, in developing transportation and construct suitable sanitary dwellings in place of the present-day slums which defy all standards of decency and health.

direct the small amounts of national savings into the capital investments that are to be made for developing the nation's productive resources. As it is not the inadequacy of the capital resources [5] that is the main fear the timidity or shyness of the small savers has to be counteracted. Accordingly, steps must be taken by the Board of National Investment to tap new sources of supply which are not now thrown open into investment channels. Thereby there would not only be an increase of supply but the small savers would be encouraged to invest. The success of the Post Office Cash Certificates, the recent flotation of big Government Rupee Loans, the occasional booms in the matter of Company flotations in spite of post-war difficulties of bad trade and labour unrest and the increase of deposits in banks and the co-operative societies which was not however at the expense of other kinds of popular savings are a convincing proof of the fact that the savings habit is increasing and, provided safety and a certain rate of interest are assured, the development of popular savings under the aegis of the National Board of Investment would be a question of mere time.[6] The sum total of our past savings stands as a positive achievement and must silence most of the jingoist talk concerning the increasingly widespread poverty among our masses.

The method of work of the Board of N. Investment.

A rough outline of its work has already been given and the means to be adopted so as to make popular savings easily available for industrial investment would have to be considered. The inertia of the small investors and the difficulties besetting their path would have to be overcome. The following are the means to be adopted for the

[5] Sir Basil Blackett hazards a guess when he says that about 12 crores of rupees can be annually invested out of savings in Government securities alone. See his Budget Speech, 1925-26. But an accurate estimate of the total investible savings is desirable. Also an idea of the classes of people who save is needed for a better understanding of our economic structure and for securing right type of investments for the same either at home or abroad.

[6] Unless such a timely move is made it is likely that the Indian deposits of the Exchange Banks and the premia amounts gathered by the foreign insurance companies conducting business in India would be finding investment outside the country. The Vice-Chairman of the Lloyd's Bank admits that roughly 54% of the deposits obtained in India are utilised in India and the rest utilised elsewhere than at the Indian Branches. Hence there is a great danger

encouragement of the investment habit on the part of the small investors. It has been rightly said that "investment is as much a science as engineering or astronomy." The small investors are as a rule ignorant of the machinery or the science of investment. There are at present no means of securing this reliable information at a cheap price. The stock-broker exists only at a few places and in the absence of Stock Exchanges even in industrial centres it is really significant that there is a marked absence of "sharks and bucket shops" which abound in such numbers in other countries. If the people do not fall an easy prey to such unreliable guides still their very absence connotes that there is no guidance in the choice of investments and the wise spreading of investments is impossible without proper guidance. Like that of insurance the science of investment consists in estimating the probability of risks and of neutralising them through combination. Hence the Board of National Investment must undertake to collect authentic information as regards our national savings and the general trend of the investment of these savings. The public debt policy of the Government can be framed according to the valuable light thrown on the total savings of the community and if the people perpetrate the crime of holding their savings in the shape of unprofitable non-interest-bearing precious metals it can be curbed by bringing home to such classes the futility of such investment which acts as an impediment for further savings and has a profound effect on the future generation. Propaganda by the Board of National Investment on the individual and national advantages of thrift is essential. It should also place facilities in the hands of the people to enable them to store the small sums as they are being saved. It should come to the people and not wait for the people to come to it.

The Investment Trusts.

The Board of National Investment must be in a position to create real Investment Trusts and supervise and audit the same. Finance

in admitting free access to the foreign banks into our money centres. Similarly, the foreign insurance companies must be forced to invest in India a certain proportion, *i.e.*, 75% at least in Indian Government on public utility securities. See Vice-Chairman's remarks at the Annual Meeting of the Shareholders of the Lloyd's Bank, 1928. The necessity to reinsure their risk is not forgotten. That is why permission to invest 25% outside India is to be granted to them.

Companies and Investment Trusts exist for the purpose of distributing the risk involved in the matter of investment by intelligently spreading it over a variety of sound investments and offer sound guidance to the small investors under this heading. It has been remarked that unless a better return of interest is offered than that of the Post Office Savings Banks or the Co-operative Credit Banks it would be difficult to tap the savings of the small investors of the country. No such trust companies which place the small investors on a similar footing with that of the big investor exist to any extent. It is only an investment trust that can help the small saver to avoid speculation by neutralisation of unavoidable risks, by diversification and by establishing a true balance between the nature of their future commitments and the nature of their investment holdings. The Investment Trusts must raise their own capital and float debentures to aid this working capital. This can be invested in a wide variety of securities always bearing in mind the principle of broad distribution of risks over many industries and over many countries or types of issue. Their clientele would chiefly consist of middle class investors who may be proprietors of the capital of these Investment Trusts or hold shares or bonds of other companies as a result of their suggestion and pioneer purchase. The delusion that an investment in gilt-edged securities or Government bonds is superior to investment in shares of companies must be shattered.

The true investment company differs from the issuing one which does financing business on a large scale.[7] The British Trusts Association is a Corporation whose shareholders are financial and investment trusts. It also undertakes underwriting on a large scale and is a central investigating organisation of any issue and propositions and undertakes to supply capital to approved British concerns and enterprises. It is a great force in leading and guiding the investment

[7] In America there is a loose terminology and the word Investment Trusts includes (*a*) Stock Conversion Trusts, (*b*) finance or holding Companies, (*c*) investment trusts. Even the real investment trusts of America cannot be considered as a desirable model for imitation for they invest only in domestic companies and limit their field of operation to certain select industries alone. There are few real investment trusts like the Investment Securities Trust of America. Hence we have to consider the English model as worthy of imitation.

of British capital. Investment Trusts are thus important factors in mobilising savings and the conservative private investors readily take up those issues which are approved and held by the Investment Trust Companies.

Although our immediate object is not to export capital, still the small investor must be in a position to get accurate information and "play a safe hand" in purchasing from the variety of good, bad or indifferent types of securities that are available. It is this idea underlying the Investment Trust that has to be borrowed and applied to organise Investment Trusts as there is no possibility of raising money cheaply at present. England could develop such institutions easily in the eighties of the last century which afforded easy economic conditions and money raised by paying 3½% could be invested abroad at 5 to 6% rate of interest. Expert and alert management would be rare and difficult to procure at cheap remuneration. An Investment Trust requires active management of its portfolio by judicious investment and re-investment. Again its holding of shares in any company must be so limited that directorial interests are not created thereby. Ample reserves should be created for emergencies. They must insist on the people understanding the fact that stocks and shares are superior to bonds or debentures. But if the Investment Trusts act in co-operation and under the rigid supervision of the Board of National Investment it would increase the popular investment on the part of shop-keepers, clerks, teachers, professional men, smaller landowners and the bigger ryots in the adjoining areas of the towns. The Board of National Investment should see that no income-tax is deducted at the source as these small investors investing through these Investment Banks fall below the exemption limit in most cases. Limitation of individual holdings of stock can be prescribed and rigidly adhered to. These Investment Trusts would be successful in developing the investment habit and *pari passu* with it we would be able to mobilise the popular savings of the small investors. The money needed for the capital expenditure of the Government of India and the Provincial Governments and the local bodies or the Provincial Land Mortgage Banks can be easily secured by this National Board of Investment issuing bonds of its own and a Government guarantee of interest would be sufficient to make these bonds popular and this

method can be resorted to if the necessary funds for capital expenditure cannot be secured by the ordinary loan programme of the Government and the local bodies. The Board of National Investment can charge a slightly higher rate of interest on the loans made by it to the Government and local bodies than what it pays to the bondholders. Repayments can be arranged on the well-known instalment basis of annuities spread over a number of years. It can be authorised to lend to other companies at approved terms on approved securities. Without encroaching on private enterprise in any matter something substantial can be done in this direction of stimulating investments by the proposed National Bank of Investment.

Municipal Savings Banks.

The starting of municipal Savings Banks on the lines of the famous Birmingham Municipal Savings Bank has been advocated by a certain section of people as a proper means of encouraging thrift, leading at the same time to sound development of local municipal bodies. Whatever might be the opinion of the Municipal Savings Bank Committee of the United Kingdom it cannot be disputed that a wisely managed Municipal Savings Bank leads to the encouragement of thrift, the wise expenditure of the mobilised funds by the municipality and the circulation of a new civic consciousness in the minds of the people. It can invest the savings in mortgages or other securities.

Theoretically speaking the widespread influence of the Municipal Savings Bank in the direction of promoting thrift and encouraging sound investment has not been disputed by the above committee and the general opinion of the observers of local financial development seems to be that unless such special conditions exist as at Birmingham it is not possible to meet with success.[8] A high civic consciousness among the people and an economic management of the bank are factors contributing towards its success. Without these favourable circumstances it would not be in the interests of our municipalities to launch out on these doubtful schemes.

[8] See the Report of the Bradbury Committee appointed to consider whether it is desirable to permit a further extension of Municipal Savings Bank C. M. D. 3014(1928). See p. 34.

Difficulties in their path.

Until the lower classes of society have higher wages than at present they would not be in a position to save and deposit in the Municipal Savings Banks. It may lead to unfair competition with the co-operative credit societies working in the municipal area and the Post Office Savings Banks might also feel the brunt of competition and any withdrawal of funds from these concerns would affect the co-operative credit movement as well as the Government of India which at present enjoys the sole use of the Post Office Savings Bank funds. Nextly the failure of the Municipal Savings Bank would damage the general credit position of the Municipality and it might also affect the credit standing of the other banks doing business with it. Municipal functions in the direction of health, education, road improvement and sanitation are more essential and an addition to this function would be like loading the willing horse, and might prove to be the last straw that might break the camel's back. Finally the main danger of financing the "housing schemes" or "welfare schemes" with Municipal Bank deposits is the locking up of capital leading perhaps towards the borrowing of funds elsewhere at a higher rate of interest to repay the depositors. Under such a contingency the main advantage of securing cheap capital would be defeated. It would be leading towards piling up of fresh duties upon the already heavily burdened executives of our Municipalities. While these are the attendant disadvantages which can however be overcome to a great degree by limiting the withdrawals in a week to a special figure, by maintaining a portion of the assets in a liquid form and by entrusting the management of the bank to banking experts and freeing the management at the same time from undue interference at the hands of the Municipal body and treating all borrowers, the poor and rich alike, on an equal footing and conducting loaning operations on strict businesslike principles, the possible benefit arising out of successful Municipal Savings Banks as promoters of thrift must not be forgotten. The possibility of securing profits by the Municipalities which are hard pressed for revenue is another incidental advantage which should be considered seriously. But when one glances at the Annual Administration Reports of the Provincial Governments

as regards the work of local bodies we find gross incompetency, flagrant mismanagement, unbusinesslike way of doing things, infringement of legal rules, excessive laxity in the matter of collection of taxes and lack of supervision over subordinates.[9] It is impossible to entrust such bodies as the smaller municipalities with the task of Savings Bank's work. The case of the District Boards and big Municipal Corporations is however different but even there Municipal Savings Banks must be subject to the supervision and audit of the Board of N. Investment. From the progress made by some of them in the post-reform period it can safely be expected that some of the executives of the bigger municipalities can efficiently manage the business of the Savings Bank but the question of its coming into competition with the existing agencies would remain unsolved unless they lower their rate of interest.

Premium Bonds.

The proposed Board of N. Investment must explore the possibilities of floating premium bonds or "bonus bonds" as they may be styled. This idea was first suggested by Sir Montagu Webb who wanted the Indian War Loan to be issued on the bonus basis. The then Secretary of State for India Mr. E. S. Montague, was of opinion that unless the principle of distributing bonuses was accepted by Great Britain India could not follow the precedent of the Continental countries in this direction. Bonus bonds are advisable as they would appeal not only as an attractive form of investment but the chance of securing a bonus which may be distributed at each quarter of the year is most appealing and provides active stimulus to investors of the middle and lower classes. They cater to the present gambling instincts of people who generally bet on the race course and an issue of bonus bonds can minimise the gambling follies on the stock exchange as well. The issue of such bonus bonds or *premium bonds* as they are styled on the European Continent is bound to be of great use in stimulating thrift and accelerating the investment habit on the part of the lower and middle classes of our society.

[9] See India in 1926-27, pp 295-303. Even now we find some of the Provincial Governments superseding the municipal executives for incompetency.

Instalment system of securing shares.

The Board of National Investment should also see that prominent joint-stock companies adopt the plan of the instalment system of selling shares to those who possess a banking account. It has been adopted at least indirectly to a certain extent by the co-operative societies under proper safeguards. The American people have been in a position to adopt this practice on a wholesale plan and the small investors have not been too slow to take advantage of such facilities.[10] The employee-share system can be adopted by enterprising industrialists and railway companies who can make available preferential securities. If the Board of National Investment supervises this scheme, this method is a suitable one for encouraging the small investors to invest in industrial undertakings. Some of the public utility companies in America, specially the Electric Companies, have undertaken the customer-share-purchase system. This is the only efficient and desirable way of checking the spread of communism in the country.

The sale of Government Securities.

The External Capital Committee recommended the sale of Government securities. The present post office organisation is doing something in this line and the suggestion that village accountants should be employed in the marketing of such Government, securities thus cutting out the complexities of the Stock Market, is a valuable one and might be adopted. But the Board of National Investment should devise continuous and lasting means and banks, co-operative credit societies, and the district treasuries should be employed by it to make available Government securities of low denomination. It alone can pursue action resembling the famous

[10] See T. N. Carver, "The Present Economic Revolution in the United States." See also R. Bockel's "Labour's Money."

Chapter on "the Workman as Stockholder." Considerable headway has to be made in this country before it can be considered that this programme is feasible. The labourer before becoming a capitalist has to build up a Savings Bank deposit, then an insurance policy and finally become a capitalist.

American " drive " for the sale of *Liberty bonds* during the period of the recent war. Something akin to this was done on a small scale in this country during the war time and by means of posters, persuasion of Government employees and widespread advertisement in places of popular resort the Government of India was able to tap the small investors' savings on a large scale. It has already been noted that the Imperial Bank has done something in this direction. Other banks should undertake to sell or purchase Government securities not only for its customers but other public at recognised rates of compensation.

The Indian joint-stock banks undertake the purchase of securities on behalf of their customers but their charges are very heavy. Brokerage fees of the broker, besides the commission to the bank, have to be paid by the investors. Instead of this double charge, *i.e.*, brokerage and commission, the practice of the English joint-stock banks in securing half of the brokerage and paying another half to the broker has to be adopted. On the European continent Banks are members of the Stock Exchange and the orders of the investing clients can be executed without any heavy charges.

Development of other sources of Capital.

The other methods of increasing capital supply beyond the development of bank credit and the perfection of the investment market must also be explored. Consumers' thrift has been pointed out already as one important source of capital. Needy industrialists and agriculturists should convert their surplus savings into actual capital aiding their enterprises. The agriculturists can depend on the direct capitalisation method to a large extent. He can dig ditches and attend to other fields of labour in his spare time. Now that the Government have adopted the policy of steady and substantial reduction of the public debt the investors must be reinvesting the same so that a net addition to the capital supply of the country can be forthcoming. The adoption of a definite plan for the redemption of the unproductive public debt and the preventing of the progressive accumulation or debt would have to be undertaken. A sound plan of redeeming public debt would itself afford opportunities for encouraging the

investment habit on the part of the people. Reinvestment of income which the rich people receive as interest on dividends is another source of capital strengthening the available funds in the investment market. Investment credit information should be supplied by specially created investment credit agencies which function on lines similar to Moody's, Poor's and Fitch's in America. Although Weekly Surveys of the Investment market are issued by the different newspapers yet the analysis of the investment credit position on the basis of general ratios relating to the capital structure, earning power and market position of the industrial securities is not offered by any Indian agency as yet. The compilers of the Indian Investors' Year Book ought to undertake this analysis before they can hope to increase the investment habit of the people in the industrial companies.

Apart from checking the flight of capital arising out of political insecurity, currency instability, oppressively threatening taxation and attractive propaganda by foreign banks,[11] a change in the industrial policy by the Government should attempt to induce the actual savers to prefer home investment Institutions of investment finance like the Investment Trust and Investment Bankers can hope to accelerate the implanting of the investment habit in the minds of small investors. The inaccessibility of genuine Stock Exchange brokers,[12] the unavailability of good industrial scrip in small lots and the speculative tendencies of the managing agents themselves stand as an effective hindrance. These can be overcome by the organisation of real investment trusts which have to be managed on approved lines by honest and capable directors well-versed in the science of investment.

[11] See my paper "Can India become a Creditor Country" read before the All-India Economic Conference held at Bombay, January, 1932.

[12] Suggestions for improving the local Stock Exchange are made in my paper, "Central Banks and Speculation," published in the Calcutta Review. See Elementary Banking, Appendix.

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CHAPTER XXV.

CONCLUSION.

The duty of the existing banks—The duty of the people—The duty of the State.

The duty of the existing Banks.

In order that India might be proud of her banking system all the existing banks would have to perform in future a straightforward, upright and legitimate banking business. They should check speculation on the part of the public who occasionally take " flyers " on the Stock Exchange with the help of bankers' money. They should keep proper cash reserve, rightly utilise their loanable money in liquid assets and be cautious in the granting of loans and in the proper selection of reliable and trustworthy clientele. The bank should take care to weed out numerous weak clients and refuse to run any risk with those who fail to provide additional satisfactory securities when they require additional accommodation. They should rigidly follow the " no risks " system and should be careful in granting uncovered credit. Too hasty and too prolific concession of credit, long-term credit, neglect of the principle of division of risk and faulty selection, excessive loans to officers, clerks and employees of the bank, loans to bank officers or others through " dummies " loaning money directly or indirectly upon the bank's own shares and transactions of a brokerage or commission business by the bank's executive officers should be scrupulously avoided. So long as the Indian banks adhere to these golden rules there is no danger as regards their self-preservation but they must take care of their customers also and provide elastic bank currency which expands and decreases with the ebb and flow of business The Indian banks should adapt themselves to the changing needs of their customers. Under the wise direction, legitimate persuasion, helpful intervention, and restraining influence of the Reserve Bank which has been created in their midst, these Indian banks should successfully function to provide this country with sound and automatic credit currency and such amount of short-term credit as is needed for its agricultural, industrial and trading requirements. In

addition to these principles the banks should realise that they are not mere dividend-paying machines. This is but to take a base and mundane view of their functions. Until they realise the loftier, nobler and higher conception of banking business these banks will not be in a position to fulfil their mission and sacred duty to our country.

The duty of the people.

It is neither the individual bank's conservative management nor the watchful guidance of the Reserve Bank that may successfully function in this country in the near future that can guarantee the soundness of our banking structure. The Indian people should realise that the modern credit system is " an inverted cone resting on an apex of gold," as Lord Avebury puts it. Sir R. Giffen rightly observes that " our credit system is to be likened to the long arm of a lever and the least touch on the cash basis displaces a weight of credit on the opposite end." F. W. Bain who continues Lord Avebury's metaphor says, " the cone is a spinning top, the point alone on which it spins being of gold, the over-hanging body consisting of paper credit. Confidence is the whipping which keeps the top revolving." A rude shock to public confidence involving the withdrawal of legal tender cash from the banks will pull the top to the ground.

The late Sir Edward Holden illustrated this fundamental truth by means of an inverted triangle. The dotted bottom of the apex is the gold basis of the whole superstructure. Withdrawal of a small portion of gold destroys a large portion of credit which in its turn affects a large portion of commerce carried on with the help of credit granted by the bank. So our people should have confidence in our banks. The depositors, other customers and shareholders should not lose their reasoning faculty at the first sign of threatened danger and withdraw their support from the banks.[1] The banks should be doing sound

[1] Such a lack of confidence was displayed at the beginning of the late war in 1914. Quite recently in March 1924, there was a run on the Bhowanipur Banking Corporation when it was known that one director had taken a loan of 3¼ lakhs of rupees. Our nationalist leader, the late Mr. C. R. Das, had to issue a manifesto to calm the minds of the depositors and his communique created confidence with the result that the bank was saved from disaster. There was such a run in 1925 on the Central Bank of India. Since that time it has often been stated that laws should be enacted against mischief-mongers bent upon ruining the credit reputation of our banks.

business and the depositors, other customers and shareholders should repose perfect trust in them. They should have mutual confidence and this increases consistently with the growth of general prosperity and social sympathy.

The duty of the State.

A Reserve Bank has been created which is to be responsible for the currency, exchange, credit and financial policy of the country. The old and effete policy pursued by the previous Finance Members of the Government of India of consulting the Legislative Assembly in all matters of currency and exchange was partly good, partly bad and partly inefficient. The consulting of non-official opinion which was occasionally done was an important step. But it is extremely unwise to expect that in such complicated and involved questions of exchange and currency, where expert financial opinion has very often gone wrong, non-official opinion would fare better. Only a few of the members of the Indian Legislative Assembly understand technical matters of this nature and to depend on their advice is entirely contrary to the policy adopted by the other enlightened countries. Relying on public opinion upon technical issues is unwise economic statesmanship. The limits of public opinion must be openly recognised, its natural lethargy and inertia recognised, its vulnerability to the stalled presentation of propaganda understood and its unconscious social and economic bias properly managed. Viscount James Bryce who realises the deficiencies of public opinion says: 'The value of public opinion depends on the extent to which it is created by that small number of thinking men who possess knowledge and the gift of initiative and on the extent to which the larger body who have no initiative but a shrewd judgment, co-operate in diffusing sound and temperate views through the community influencing that still larger mass who deficient in knowledge and lacking interest follow the lead given to them. Two dangers threaten all modern democracies. One is the tendency to allow self-interest to grasp the machinery of Government and turn that machinery to its ignoble ends. The other is the irresponsible power wielded by those who supply the people with the materials they need for judging men and measures. The

dissemination by the printed word of untruths and fallacies and incitements to violence which we have learned to call propaganda has become a more potent influence among the masses in large countries than the demagogue ever was in the small nations of former days. To combat these dangers more insight and sympathy as well as more energy and patriotism are needed than the so-called upper and educated classes have hitherto displayed." [2]

The sterling exchange standard has been adopted by the Legislature in *1931* October and has continued to function till it was formally enthroned as our monetary standard in the Reserve Bank Act. The Government would have nothing to do with it as its managing body. As Dr. Marshall says, "the function of the legislature as regards currency is to do as little as possible. Almost any currency of which the position is certain will do its work fairly well. Frequent changes in its basis disturb expectations and infuse a spirit of unrest into business. They may all aim at increased certainty but their effect must on the balance be increased uncertainty. They resemble the frequent waking of a patient in order to administer sleeping draughts." [3] In the times of an extraordinary crisis or of a prolonged war when the inflation of currency is an inevitable expedient to finance the war, the Government treasury would be justified in manipulating it. Even then the aid and co-operation of the Central Bank has to be enlisted. Almost all civilised countries have left the regulation of currency and exchange to the automatic forces of trade expansion and contraction through the machinery of the Central Banks acting in co-operation with the ordinary joint-stock banks. Such enlightened and conscious regulation of credit and currency should be the ideal to be striven for. The Central Bank's contribution towards stability should be the cheapening of this elastic credit and an effective control over it.

The future of our Banking.

By means of disinterested and painstaking investigation the Central Banking Enquiry Committee and the Provincial Banking

[2] See Viscount Bryce," Modern Democracies," pp. 456-57 and *459 to 460*. See Chapters XV and XXVIII.

[3] See answer 11187, 1899 Committee on Indian Currency.

Enquiry Committees have pointed out that the credit structure is not well-adapted to our actual requirements. Though their actual recommendations were not virtually carried out they have bequeathed to posterity a mass of banking literature on the different important banking practices of this country which even after the lapse of so much time aptly repays perusal. There are several reasons which make the study of the foreign banking systems very helpful to us at this stage of banking progress in this country. Entering upon a career as a modern state when the financial system of other countries has been perfected the problem of adapting the present financial system to suit the future needs of agriculture, commerce and industry, becomes an easy task if a keen and comparative study of some of the suitable features that can be borrowed is made by a competent set of observers. The remodelling of our present financial system on the basis of the accumulated experience of others is the only thing feasible. The pioneering work in banking need not be done by this country and Indians might after all be unfit for this work. The task of learning things by a process of trial and error is too tardy and is bound to produce disastrous effects in the absence of individual initiative, efficiency, energy and management. Now that the Banking Committee has examined the banking technique already in existence it is time we ought to take advantage of the results of the genius of other lands. With due regard to our special conditions and limitations we can make use of the lessons we learn from other countries. The task of creating a new banking organisation would undoubtedly have to be attempted by the people.

State's duty towards depositors.

Although I agree with the opinion that the interests of the depositors of the bank have to be safeguarded I consider that there are other important issues to-day and the All-India Bankers' Association can do immense service to the public and secure manifest advantages to the banks by subjecting the present banking technique and actual practice of the credit institutions to a careful and expert consideration. Fundamental changes are necessary in the banking business throughout the country. Until the depositors are convinced that everything possible

is being done to enable the banks to properly invest their funds, there will be no prosperity for either the depositors or the banks and the economic progress of the country would be impossible in the absence of strong banking institutions thoroughly deserving the utmost confidence on the part of the depositors. Until the depositors are given a share in the working of the banking business no efficient organisation of banking is possible. In the complete reconstruction and new orientation of the banking business the State has to play a fundamental part and without its active supervision of the banking units a better and more effective utilisation of the hoarded wealth would not be forthcoming. Without an adequately developed banking habit the banking system of the country cannot hope to secure a large quantity of working capital and finance the evergrowing requirements of agriculture, commerce and industry. It is by this method alone that a real improvement in the standard of living can be brought about.

Other important issues.

The subject is indeed too large to permit of my entering into detail on this occasion but I am convinced that the All-India Bankers' Association must hold the most disinterested and painstaking investigation into the principles on which a Central Bank of Issue has to be worked and also outline the operations that it has to undertake. Its position as the central institution and custodian of our monetary resources has to be carefully outlined. Without the successful working of a Central Bank the monetary policy cannot be shaped in an intelligent manner so as to produce the greatest possible benefit to the entrepreneurs of society and cause no loss to the revenues of the Government. It should succeed in establishing a banking system which can adapt itself to the expansion and contraction of legal tender currency as would happen normally in seasonal periods of the year or in such abnormal events as a banking and commercial crisis. A re-examination of some of the important items of the Reserve Bank Act and the filling up of the gaps [4] are essential preliminaries. It has

[4] See my Lecture on "Gaps in the Reserve Banking Act." Lecture delivered at Masulipatam quoted in the *Hindu* (Madras Daily).

it happened that the Imperial Bank alone has been selected as the sole agent of the Reserve Bank. It has led to the setting up of the cry of favouritism. The Imperial Bank should not be the only " pet " bank. In the interests of banking progress it is essential to appoint other sound banks for its agency work. Even now the Federal Government of the U. S. A. places its balances in some of the national banks. It is indeed true that this system has its own defects but in the peculiar circumstances of our country it is hard to expect the general public to repose trust in such banks which are not selected as depositaries of public money.[5]

Likewise there should be no restriction on local governing bodies to place their deposits in any bank they may choose. Already some of the District and Local Boards are depositing their balance in the Co-operative Central Banks existing in their centres. The prevailing practice in the Scottish Banking system favours this idea. There is keen competition on the part of the existing English joint-stock Banks to secure the accounts of Municipal bodies and other quasi-Government organisations.

The All-India Bankers' Association has to suggest measures for the proper re-organisation and effective co-ordination and linking up of the up-country monetary centres with the provincial and national money markets of the country in Bombay and Calcutta.

It has to examine all credit instruments of evidence of indebtedness in connection with loans and discount business and bring about uniformity in bills of exchange, acceptances, bonds and stocks and debentures. The American Acceptance Council and the American Bankers' Association are trying their level best to substitute standard

[5] The practice of appointing different banks as agents of the Treasury was once contemplated in this country. It was suggested in 1861 that the Bank of Agra was to be given the Treasury Work at Agra and Lucknow while the Presidency Bank of Bengal was to be given the Treasury Work at Allahabad, Delhi, Lahore, Jubbulpore and Nagpore. This was to a certain extent responsible for the branch expansion policy of the Presidency banks. So the suggestion of appointing other banks as agents of the Reserve Bank deserves responsible re-examination in a dispassionate manner. The main advantage of such a step is to give the selected banks good prospects of pure development and assures them of a settled position. The attendant disadvantage of Government funds being lent at different rates by competing banks would ensue and if there are too many depositaries it is likely to react adversely on the standard of banking. The advantages promise to outweigh the possible disadvantages and for a few years this practice has to be carried out under proper safeguards.

forms. The necessity of employing uniform phraseology for the various forms of credit instruments, instructions and advices need not be emphasised by the present writer.

Another useful point of enquiry would be to make a detailed study of the extent to which machines can be used in banking offices in connection with heavy statistical work in the office. Accounting and tabulating machinery are being brought into increasing use by the American banks. Like the Indian Railways which are making an increasing use of these machines the banks must be able to adopt them so as to cope with the increasing volume of work without excessive additional cost, sacrifice of accuracy and speed in work.

The All-India Bankers' Association should point out the steps necessary to fuse the indigenous bankers, shroffs and other money-lending intermediaries as integral parts of a properly organised banking machinery. The possibility of developing them into modern bankers or bill-brokers as was successfully done by the Japanese people in their country must be investigated.

Nextly the All-India Bankers' Association has to enquire into the different types of banks that are essential for the country. Any healthy community requires several distinct groups of banks whose special functions should be mutually exclusive. How far State aid or the sympathetic attitude and discriminating help of the State can be invoked for the purpose of initiating these diverse types of banks such as exchange, industrial, mortgage and investment bank has to be studied. The success of the Co-operative Movement is undoubtedly due to State enterprise from the outset maintained to a certain extent even to the present time and the method by which audit and supervision were enforced have proved very effective. The State has decided to take the initiative in helping the land mortgage banks. Its systemetic efforts aided by the co-operative action of the public would tend much towards the economic re-organisation of the agricultural industry. The local moneylenders who might lose their privileged position on the introduction of land mortgage banking cannot hope to offer any effective resistance to official policy.

Indian banking autonomy is no less essential for the economic progress of the country than political autonomy or freedom to formulate measures for the social improvement of the country. Unless

a new spirit is infused into the existing banking units so as to rationalise all their banking activities any attempt to adjust the supply of credit to the probable demands on the other side cannot succeed. Till a thorough rationalisation of the banking industry exists agriculture, commerce and industry cannot base their estimates for years ahead and they cannot be established with any degree of strength, capacity or success. Rationalising of banking by introducing the much needed element of specialisation by diversified banking units seeks to make a scientific study of the existing industries and industrial potentialities of the country to promote industrial progress. Rationalisation of banking seeks to promote the specialisation of credit and the more efficient use of credit. It is to the banker, the chemist, the physicist and the engineer that India has to look to recreate her economic conditions and lead to the fuller utilisation of her small and dormant hoards of precious metals and a better working out of the industrial opportunities thereby increasing the total wealth of the country and the prosperity of the people.

APPENDIX I.

Table of Money Rates—1933-34.

1st of		Bank rate.	Call money rate. Calcutta.	Call money rate. Bombay.	Imperial Bank Hundi rate. Per cent.	Bazar bill rate. Calcutta. Per cent.	Bazar bill rate. Bombay. Per cent.
April,	1933	3½	3/4	2	3½	6-7	4 1/8
May,	,,	3½	3/4	2½	3½	6-7	4 1/2
June,	,,	3½	1/2	1½	3½	7-8	4½
July,	,,	3½	3/4	3½	3½	6-7	3 3/8
August,	,,	3½	1/2	1	3½	6-7	2¼
September,	,,	3½	1/2	1/2	3½	6-7	2 1/4
October,	,,	3½	3/4	3/4 (*a*)	3½	6-7	2 1/4
November,	,,	3½	1/2	1/2	3½	6-7	2 1/4
December,	,,	3½	1/2	2	3½	6-7	2 5/8
January,	1934	3½	3/4	2¾ (*a*)	3½ (*a*)	6-7	4 1-8 (*a*)
February,	,,	3½	3/4	2¼	3½	6-7	4½
March,	,,	3½	3/4	2½ (*a*)	3½ (*a*)	6-7	6 (*a*)

(*a*) On the 2nd of the month.

See the Report of the Controller of Currency for 1933-34 (p. 74). For previous years these Reports may be consulted.

Lessons to be drawn from the above tables.

1. In the earlier editions we noticed the wide range of the fluctuations of the bank rate between the slack and the busy seasons— July to October is the slack season where money rates are easy ; cash balances are large during this period and the bank rate and the

Imperial Bank Hundi Rate are mainly dependent on the cash balances of the Imperial Bank. Since these lines have been written the uniformity of the bank rate all through the year is a noticeable feature.

2. Note the lack of uniformity of the rates in the different parts of the country. The Bombay rates easily disclose the competition that exists for the bill-discounting and the nearer approach of the bazar rate to the Imperial Bank Hundi Rate.

3. See the diversity of *money rates* in the Indian money market. Besides these there are deposit rates and the loan rates for the different kinds of securities that are offered as collateral.

4. Note the high rate which the merchants have to pay in the bazar for getting their bills discounted by the indigenous bankers. If this rate is to be lowered as it should be in the interests of the traders and consumers, the indigenous bankers or the shroffs should secure greater funds through the joint-stock banks and specialise in discounting bills. So long as they pay *slightly higher* deposit rate than the joint-stock banks there is no reason why they should be deprived of this source of working capital. For a discussion of this measure see the chapter on the *Indigenous Banker.*

5. The most remarkable fact which has escaped the comment of all financial experts is the exact coincidence between the Imperial Bank's Bank Rate and the Hundi Rate during *1927-28.* If such conditions were to prevail in future the Bank Rate will mean, as in the case of the Local Money Market, the rate at which first class bills are discounted by the Imperial Bank. Since these lines have been written the Imperial Bank's Bank Rate as well as the Imperial Bank's Hundi Rate are the same during the *year 1933-34.*

6. Note the changes in the call-money rate of Bombay where the rate is usually *high.* Sometimes the nervousness prevailing in the money market is leading to the appearance of high call-money rates.

APPENDIX II.

A Brief Account of the Early proposals for a Central Bank of Issue.

The proposal for the establishing of a great banking institution [1] which is to be a quasi-public institution can be traced to a very distant date. ' It was in November, 1936" "that a body of merchants interested in the East Indies approached the Court of Directors of the East India Company with the proposal for a great banking establishment for it would facilitate the employment in India of the redundant capital of England, stabilise the monetary system and be of great use for the receipt of revenue and for the remittance to England of the money required for the home charges and to enable the East India Company to act up to the intentions of the Legislature." This proposal was referred to the Bank of Bengal for consideration. It was of opinion that it was capable of doing the aforesaid business without having recourse to England. Thus ended the proposal and nothing tangible came out of it.

The second mention of such a great banking establishment was made by the Right Hon'ble James Wilson while advocating the establishment of state-managed currency in India.[2] Mr. Samuel Laing, the next Finance Member, also viewed the proposal favourably. In his view "a Central Bank with State connection as exists between the Government and the Bank of England would be a great convenience to commerce and an important resource to the State." [3]

[1] See the Parliamentary Papers relating to banks published in 1868-70. A still earlier proposal of Mr. R. Rickards made in 1808 deserves mention. Considerations of space forced me to omit a discussion of this scheme. A brief discussion of it will be in my doctorate thesis "Organised Banking in the Days of John Company."

[2] Proposals have been made for the purpose of establishing on a large scale and with an adequate capital a national banking establishment capable of gradually embracing the great banking operations in India and of its branches to the interior trading centres as opportunity might offer. That there is a growing want for such an institution and a rapidly increasing field for its operations no one can doubt.

See Parliamentary papers relating to Paper Currency in India, 1861.

[3] See Minute, dated 7th May, 1862.

The next attempt to create a Central Bank was made in March, 1867, when the old Bank of Bombay failed and the Bank of Bengal proposed an amalgamation of the three Presidency Banks According to Mr. G. Dickson, the originator of the scheme, the following were the advantages to be expected out of it. "It would meet the legitimate requirements of commerce, control the recurring monetary crises and secure an unvarying management of the Treasuries under a controlling power; afford a certainty of greater economy in the use and distribution of the balances throughout in India, provide for a uniform management of the paper currency and of the public debt under the same safeguard but with enlarged security and create a powerful agent in aiding them in all their financial resources and whose powerful action would be felt throughout the country." Although the Government contemplated inducing men of commercial ability and experience as well as men of high standing and character to come to India and manage the Central Bank the proposal was not carried out as the shareholders of the Bank of Bombay negatived the scheme. The Viceroy condemned the proposal on the ground that the influence of such an institution would overshadow that of the Government itself; that such an institution would be difficult to manage and that Madras and Bombay would prefer separate institutions to look after their interests. The Government had to pass Act XI of 1876 reconstituting the business of the Presidency Banks to cope with the needs of the situation.

The creation of a Central Bank of Issue on the model of the Nederlands Bank was suggested in 1884 but "it was not cared for on the understanding that India possessed a sound banking and currency system." [4]

During the years 1899-1901 measures for the establishment of a Central Bank were in the air and there was much correspondence on this subject between the Secretary of State for India and the Government of India. This question was keenly discussed by many of the witnesses who appeared before the Fowler Committee of 1898. Alfred Rothschild elaborated a scheme of his own for a State Bank to arise out of the three Presidency Banks. The Central Bank was to be started with a capital of £14,000,000 sterling to be held partly in gold

[4] Sir Richard Temple, India in 1880, p. 469.

and partly in securities and it was to be granted the power to issue notes against the whole of the capital. The Presidency Banks were to be amalgamated with it. It was to hold Government balances and to have the right to import silver free of duty and to share in profits of coinage. It was to take no part in Foreign Exchange business but to confine itself to internal operations. The Government was to come to the rescue of the bank to the extent of £10,000,00. Sir Edward Hambro, one of the members of the Fowler Committee, wrote a separate memorandum urging the establishment of a State Bank modelled on the Bank of France.[5] He thought that the Central Bank would give great assistance to the Government in the matter of regulation with reference to the convertibility of the rupee and would act as an initiator of banking facilities like the bank of France. The Secretary of State for India referred the proposal to the Government of India.[6] But Sir Edward Law, the then Finance Member, negatived this magnificent proposal on the following grounds: " There is under the present condition no real necessity for the foundation of such a bank in the interests of trade and although the existence of a strong bank with abundant resources would be useful in connection with possible exchange difficulties and would from other points of view be convenient to Government, the direct cost of the establishment would be greater than I venture for acceptance. I am convinced that it is unnecessary to establish such a bank for the assistance of trade and unprofitable as regards the provision of assistance in connection with possible exchange difficulties, but still if practical difficulties could be overcome it would be distinctly advisable to establish such a bank so as to relieve the Government of the present heavy responsibilities and to secure the advantages arising from the control of the banking system of the country by a solid powerful central institution. The difficulty of securing a suitable Board of Directors having the necessary leisure to do business is very great. There are practical difficulties in the way of amalgamation arising out of provincial and personal

[5] He might necessarily have derived this suggestion from Mr. Ellis who just wrote to this effect so long ago as 1870.

[6] See paragraph 9 of Despatch from the Secretary of State No. 140 (Financial) 25th July, 1899.

jealousies." [7] The Secretary of State considered the proposal to be a good one but as time was inopportune [8] the proposal was laid aside as an impracticable one in the range of practical finance.

Lord Curzon favoured the idea of centralisation of banking facilities to be secured by the amalgamation of the Presidency Banks and proposed to grant access to it to the London Money Market thus "enabling it to act as a permanent and stable link between the English and the Indian money markets." [9] The Presidency Banks however objected to the creation of a Central Bank by consolidating the Presidency Banks and the idea had to be dropped once more.[10] In spite of the recommendations of the informal conference nothing could result out of its recommendations as the Presidency Banks refused to consider the question of amalgamation.

During 1910 and 1913 fresh proposals for the starting of a Central Bank were made and the most prominent of such proposals were those of Sir Edward Holden and the London Times. The Under-Secretary of State for India, Mr. Montagu, frankly approved the idea of a State Bank.

In 1913 Lord Crewe invited the late Sir Lionel Abrahams of the India Office to draw up a memorandum on the subject of the Central Bank. According to Sir Lionel "the depositing in this institution of the whole or the part of the money kept under existing conditions in the district and reserve Treasuries would place plenty of funds at the disposal of trade and industry." The substitution of the drafts on the London Office of the State Bank for Council Bills, the borrowing power of the Government both in India and England were the other advantages commented on by Sir Lionel. But he considered that "the banks of Madras and Bombay would lose their importance and that certain technical difficulties between London and India would

7 See Sir Edward Law's Minute on the Central Bank Proposal, January 31, 1901.

8 Papers relating to State Bank printed in 1913 from the Gazette of India (1899-1901 publications), p. 85.

9 See his speech on the Presidency Banks Bill—Friday *1st September, 1899.*

10 See J. Begbie's letter, dated the 21st December, 1899, to the Secretary of the Government of Bombay, Finance Department.

have to be overcome." [11] This memorandum was placed before the Chamberlain Commission.

The Chamberlain Commission found it difficult to examine the State or Central Bank proposal owing to the absence of anything in the nature of a concrete scheme and even of any general statement as to what was implied by the phrase " State or Central Bank." It requested Mr. J. M. Keynes and Sir E. Cable to draw up a memorandum on this question. With the help of Lord Inchcape, Keynes drew up an elaborate scheme and this report was more optimistic about the working of the State Bank than Sir Lionel's. Keynes pointed out the defects of the existing banking machinery and money market and according to him the best way to strengthen the position was to have a State Bank. Keynes stated the numerous objections to the scheme and disposed them off with easy and effective reasoning. The Chamberlain Commission recommended the appointment of a body of select experts to consider this question. During the period of the war the question was shelved and the Hon'ble Mr. (now Sir) B. N. Sarma's resolution upon the State Bank gave scope for discussion. In place of the State Bank the present Imperial Bank was created in 1920. But its failure to act as a real Central Bank for the banking system of the country soon opened the eyes of the people and Pandit Malaviya voiced this sentiment before the External Capital Committee. The Hilton-Young Commission took up this issue which was so long and indefinitely delayed and has done signal service to the country in recommending the starting of a Central Bank of Issue to be styled the " Reserve Bank for India."

[11] See Sir Lionel Abrahams' Memorandum, Appendix No. 14—Interim Report of the Chamberlain Commission.

APPENDIX III.

The Presidency Banks.

The absence of vigorous and strong private banks, the circulation of depreciated currency, the lack of artificial capital, arising from credit, or the circulation of paper money, the non-existence of a money market which made it difficult for the Government and the private businessmen to borrow on easy terms, the scarcity of specie and the abnormal influence which local bankers exerted on the value of the Treasury bills [1] of the Government soon prompted the financial advisers of the Government to recommend the starting of a quasi-Government Bank which would afford sufficient security to the public, provide for a faithful administration of its affairs and enable the Government in times of sudden emergency to obtain necessary financial aid and regain their credit in the money market.

In addition to the financial embarrassment of the Government the financial credit and prestige of the Government was at a low ebb and the Government paper could not circulate at par and a heavy discount was attached to the different denominations of the Government securities.[2] To cure these different evils the starting of a bank aided and controlled by the Government, which would

[1] The origin of the present bank was due to the Accountant General, Henry St. George Tucker As the best method to improve the state of finances he suggested the formation of a quasi-Government Bank in a letter to the Marquis of Wellesley (14th July, 1801). It is advantageous to note his objections to a Government Bank for these are the very grounds on which the State Bank scheme is criticised during the modern days. "It would not be distinguished from the Government's Treasury, the public would consider it an engine of state. It would be involved in all the transactions of the Government and there is reason to apprehend that the public under these circumstances would not have sufficient confidence in it. It would necessarily participate in the Government's distress and its credit would be least when there might be the greatest occasion for credit in times of public calamity." (Quoted from Henry St. George Tucker's criticism of the Madras Bank's plan started by Lord William Bentinck in 1805.)

[2] See the issues of the Asiatic Annual Registers, June, 5, 1802-1803, p. 6; April, 25, 18 3-11 issue, p. 96; August, 24, 1804, p. 96; June, 1805, March, 24, 1805; April, 20, 1807—subsequent issues give the quotation of the different forms of Company's paper,

be a part-proprietor of it, was at last undertaken in 1806. The Bank of Calcutta was organised in 1806, with a capital of *sicca* Rs. 50,00,000 in 500 shares of Rs. 10,000 each.[3] The Government of Bengal contributed about one fifth of the capital. Although this original capital of the Bank was increased successively during later years as in 1836, 1838 and 1864 the portion of the Government capital did not increase in due proportion. In 1876 the Government thought it wise to sever its connection with a commercial body. It relinquished the right of representation on the Board of Directors. Up till this year the Government nominated three Directors to participate in the Board of Management along with six other mercantile directors elected by the shareholders. The Secretary and Treasurer of the bank was always a covenanted Civilian Officer until 1854.

The bank received its charter of incorporation on 2nd January, 1809, and the name was altered to that of "the Bank of Bengal." The charter not only defined the objects for which the bank was created but it prohibited the bank from conducting certain operations which would have brought disaster on the bank. A careful comparison of the different provisions in the charter with those of the 1695 Charter of the Bank of England, will lead one to the conclusion that the Indian institution was modelled carefully on the English original. Like the Bank of England which was prohibited from lending more than what the Parliament sanctioned, the Bank of Bengal was also prohibited from lending more than one lakh to any individual and five lakhs of Rupees to the Government. The bank's rate of interest was not to rise higher than 12% and the Bank of England was also prohibited from raising its rate above 5% till the year 1839. It was after repealing the usury laws in that year that the Bank of England could discover the effective control exercised by its discount rate in the L. M. Market. The amount of stock which any share-

3 The bank began business with the public on 2nd June, 1806, although the first call of the share capital was received on May 1st, 1806. Dr. H. Sinha says that Symes Scutt has failed to mention this fact. However this is an oversight, for on p. 13 of his printed and circulated book the History of the Bank of Bengal, the Calcutta Gazette advertisement with reference to the commencement of the actual business was actually quoted. "Monday, 2nd June"—was distinctly mentioned on p. 13 of the book. He later on mentions that accounts with individuals were opened from Monday the 2nd March, 1807.

holder of the Bank of Bengal could hold was limited to one lakh. The bank could not conduct trade or do any other kind of agency for the buying and selling of public securities or goods. The Charter also provided that (1) a cash reserve of at least one-third of the outstanding liabilities payable on demand should be kept and (2) the total liabilities of the bank including deposits, note-issue, etc., were not to exceed the bank's capital of Rs. 50 lakhs.[4] The Charter provided for 2 meetings of shareholders yearly and contemplated the possibility of putting an end to the corporation after giving one year's notice to it.

The Charter of the Bank of Bengal was renewed in 1823[5] permitting the bank to issue notes up to 2 crores and the proportion of cash to liabilities was reduced from $\frac{1}{3}$ to $\frac{1}{4}$. In 1824 a fraud was practised and the dividend rate fell to 2½ per cent. In 1825 the bank opened its first agency at Benares by transferring the Government stock to that place and selling it there and negotiating drafts against the proceeds thereof. The bank began to issue post-bills by 1826. A room was set aside for sale and purchase of public securities between 2 and 3 P.M. In 1829 forgeries were conducted by one Rajkissore Dutt. During these years, 1829-1832, the Agency Houses of Calcutta failed and the Bank of Bengal had to experience a severe crisis and break several provisions of its Charter. To avoid the cataclysm of ruin and failure the Bank of Bengal had to pursue the expensive theory of lending freely to some of the solvent firms enmeshed in difficulties as a result of the failure of the commercial firms of the city. The first half-yearly balance-sheet was published

[4] J. B. Brunyate, footnote, p. 3.

[5] In order to meet the growing requirements of trade of the extended population of Calcutta it was proposed to double the capital in June, 1822. The bank sent in a letter to that effect to Lord Hastings. The Government did not feel inclined to satisfy the bank's wishes in this respect and as a compromise suggested by the Accountant General, J. W. Sherer, it was proposed to permit the bank to increase the note-issue to four times the capital and the Charter was granted for a period of 5 years. Another benefit which the Government conferred on the bank was the remission of Government bonds deposited as security for receipt of bank notes.

[6] Even indigo factories had to be taken up under the bank's management in payment of the debts of Alexander & Co. which failed. See Brunyate, "An Account of the Presidency Banks," p. 6.

in 1833. In the year 1834 the value of bank shares fell from Rs. 6,000 to Rs. 500 premium and even to par due to dividend being written off for losses on account of forgeries. But the bank survived these bad days and began to prosper gradually. By the 1836 Charter the bank capital was raised to 15 lakhs of Company's Rupees.[7] Not finding this sufficient to cope with the increasing competition of the Union Bank it soon obtained permission by Act XXIV of 1838 to raise its capital from Rs. 75 lakhs to 112½ lakhs of Company's rupees. A fresh charter revised most of the older regulations with reference to loans[8] and permitted the bank to conduct even exchange operations but they made the significant addition of the words "payable in India" after the words "buying and selling bills of exchange" as a result of the suggestion made by Director Cockerell. An agency was opened at Mirzapore and the bank began to extend its usefulness to its customers by undertaking to realise interest on Government and other securities on behalf of its clients. Up till 1854 much of its business consisted in investing in Government securities and lending on Government securities. Act XXI of 1854 empowered the Deputy Secretary to sign for the bank and power was given to advance against shares of guaranteed railways. Another modification was introduced by Act XXVII of 1855 which permitted the bark to receive, purchase, sell and realise interest on securities and shares at the same charges which hold good at the present day. The first weekly statement was issued on 16th January, 1856. A glance at the balance-sheet would reveal the nature of the bank's transactions at that time.[9]

[7] After the Sicca Rupee the Company's Rupee (the present rupee was adopted in 1835 and the Bank of Bengal had to adopt it in its accounts from 1836.)

[8] The former limit of advance, *i.e.*, 1 lac, was raised to 3 lacs. Another salutary measure was the provision for the formation of a Reserve Fund which was not however to exceed 5% of the capital stock of the bank. Permission to open branches was also granted; the regulations with reference to the cash reserve remained unaltered.

[9]

Liabilities.		Rs.	A.	P.	*Assets.*		Rs.	A.	P.
Bank's Capital	...	1,07,00 000	0	0	Govt. Securities		25,18,796	5	10
Reserve Fund	...	1,98,245	8	0	Due from Govt.	...	22,459	9	10
Current Accounts	...	85,76,740	14	1	Mint Certificates	...	48,94,149	15	11
Other claims	...	97,892	9	10	Cash	...	61,29,708	4	2
Bank Notes and Post Bills.		1,46,86,852	9	11	Loans	...	1,76,08,819	9	9
					Govt. Bills discounted	...	94,306	7	7
					Mercantile Bills	...	28,30,187	9	9
					Dead Stock	...	1,63,303	11	4
Total	...	3,42,59,731	10	2	Total	...	3,42,59,731	10	2

The business of the bank began to increase and about ten European Officers furnishing adequate security were employed to cope with the increasing work and a new satisfactory system of working with *check Ledgers* in English was introduced.[10] Thanks to the vigilance of the Government Directors, the Bank of Bengal did not contract any bad debts during the days of Great Sepoy Mutiny of 1857. Although the percentage of cash went down to 22·5% it escaped disaster. The distrust of the Indian people was so great that they took the earliest opportunity to convert the bank notes into silver. Credit was severely contracted during this great financial upheaval. The bank soon regained its lost business and by 1862 it began to open branches in Rangoon, Mirzapore, Benares, Patna and Dacca. Owing to the inauguration of the Government Paper currency in 1862 the Bank of Bengal, like its sister institutions of Bombay and Madras lost its privilege of note-issue.

In order to compensate the loss it was agreed to transfer the General Treasury to the bank and the minimum guaranteed sum of 50 lakhs of rupees was to be granted to the bank as Government Deposit. The bank was to be given yearly payment of Rs. 43,606 as cost and expenses to the bank for carrying on the work of the Government Treasury. It was also arranged that the management of the Government currency was to be placed in the hands of the bank and a commission of $\frac{3}{4}$ % per annum on the daily average of currency notes outstanding and in circulation through the said agency of the bank was to be given to the bank. The Charter of the bank was revised in 1862 permitting the bank to raise its capital from 107 lakhs to Rs. 300 lakhs and empowered the bank to frame bye-laws and to enter into agreements with the Government and advances against goods, wares and merchandise which were not of a perishable nature could be made. The regulations with reference to loans to individuals were removed. Although the power of control remained unchanged in the hands of the Government great freedom was granted to the bank's officers in the matter of framing bye-laws.

The Bank of Bengal soon opened branches in Allahabad, Nagpore and Lucknow and began to manage the treasury work at Nagpore, Saugor, Jubbulpore, Patna, Rangoon, Dacca and Cawnpore. The

10 See Symes Soutt, " Histoiy of the Bank of Bengal."

management of the Government Savings Bank was taken over on 1st September 1863, and Symes Scutt says that " a monthly compensation of Rs. 750 was granted for this special work on behalf of the Government." The bank began to increase its capital in 1864 and branches at Moulmein and Hosingabad were opened in 1865. The management of the Registered Public Debt at Calcutta was entrusted to it and Rs. 3,500 were to be paid yearly for each crore of the Registered Public Debt managed by it. It was deprived of the Agency of note-issue and the terms of agreement with reference to Government deposit of cash balances were revised in 1866. The average cash balance was to be 70 lakhs at the Bank of Bengal but if it was to fall below 45 lakhs interest was to be paid on the difference between the actual deposit sum and minimum deposit of 45 lakhs. The bank was permitted to use the Government balances at the branches. It was also settled that Rs. 24,990 paid for branch establishments was to cease after 1st March, 1869.

The Bank of Bengal had to experience another troublous period from 1863-66. As the Bank of Bengal locked up its funds to a great extent it was unable to meet the demand of the Government on the public balances it held under its custody.

Although a very severe crisis occurred in 1866 and six prominent banks had to be closed in Bombay, the Bank of Bengal, thanks to the able management of G. Dickson, earned larger profits than usual and in 1867 it opened its branch in Bombay and until 1876 the bank generally maintained high cash balances, sometimes rising to 5 crores of rupees, as a result of contracted credit during days of trade depression and financial distrust.

In 1876 an elaborate systematic Act applying to all the Presidency Banks was drafted and with some minor amendments by Act V of 1879, Act XX of 1899 ,Act I of 1909 and Act VIII of 1916, it governed the business of the Presidency Banks. The Presidency Banks became pure private concerns ; the Government sold its shares and lost also the right of representation on the Board of Directors. The power of control and authority to-call for information and papers regarding bank's affairs was only conditionally retained. Short regulations with reference to loans and advances were reinforced and even the nature of securities on which loans could be made was closely

defined. The business that could be conducted was also clearly outlined.

The Bank of Bombay was started in 1840.[11] Though the proposal was first projected in 1837 it could not materialise on account of the opposition of large capitalists. The capital was divided into five thousand two hundred and twenty-five shares of Rs. 1,000 each. The Government of Bombay invested about 3 lakhs as their contribution towards the share capital of the bank. It nominated three Directors and the charter was closely modelled on that of the Bank of Bengal. There were extensive forgeries committed during the years 1848-1851 and the Bank of Bombay failed in 1868. Though the bank paid its liabilities in full, about 187 lakhs of capital out of a total of 210 lakhs were lost.

The chief cause for the failure of the bank was the speculative mania of these days. A commission under the Presidency of Sir C. Jackson was appointed to enquire into the causes of its failure. The report attributes the failure to the following causes: (*a*) the Bank Charter Act of 1863 removed many of the restrictions contained in the Act of 1840 and permitted the bank to transact business of an unsafe character ; (*b*) the abuse of the powers given by the Act of 1863 by weak and unprincipled secretaries ; (*c*) the negligence and incapacity of the directors who omitted to pass bye-laws and did not exercise proper supervision over the secretaries ; (*d*) the very exceptional nature of the times ; (*e*) the absence of sound legal advice and assistance. According to Sir C. Jackson the failure taught the great lesson that " banks should not lend money on promissory notes when all the parties were borrowers and not any of them securities for others ." Throughout its period of existence it could not compete successfully with the senior Presidency Bank.[12]

The new Bank of Bombay was started in 1868. From 1870 to 74 it had to experience difficulties. The Government could not draw on its balances entrusted to this bank. This together with the incident

11 Greater details about its working are given by Cooke Brunyate, or the anonymous writer of the pamphlet " The Late Bank of Bombay." These are also given in my book entitled " Organised Banking in the Days of John Company."—Published by Lal Chand & Sons, Calcutta.

12 Sir Bartle Frere's Minute of 1868—quoted by Brunyate, p. 111.

of 1863 in the case of the Bank of Bengal opened the eyes of the Government as to the danger of completely merging their balances with those in the Presidency Bank. This led to the institution of Reserve Treasuries at the Presidency towns to hold the balances which were hitherto deposited in the Presidency Bank.[13] The Bank Charter Act of 1876 was made applicable to this bank. The Bank of Bombay began to prosper from that day thanks mainly to its rigid restrictions.

At a meeting held on the suggestion of the local Chamber of Commerce at the College Hall of Madras on the 18th May 1840 it was resolved to establish a bank with a capital of 30 lakhs (3,000 shares of Rs. 1,000 each) and the business of the bank was to be conducted under "the same restrictions as that of the Bank of Bengal and the Union Bank of Calcutta." In little more than a fortnight shares worth 27 lakhs of Rupees thrown open to public subscription were taken up by them.[14]

Lord Elphinstone took 50 shares. The remaining shares of the value of 3 lakhs of rupees were taken up by the Government of Madras. The plan was meant to enlarge the old established Government Bank upon the principles of the Chartered Bank of Bengal and Bombay by admitting shareholders with its consequent changes in discontinued management and having an improvement in the conduct of the business. The Bank of Madras was started in 1843[15] and received its charter of incorporation in the same year. It issued notes till 1861. The Bank Charter Act of 1876 was applied to this bank and from that date it had no chequered history as in the case of the first Bank of Bombay.[16] It did good service in popularising banking business in that Presidency.

Even after 1876 the Presidency Banks did not play a useful part in the financial system of the country owing to the rigid restrictions under which they were forced to do their business. Some writers have

13 See Herald, June 6th, 1840, quote by the Asiatic Journal.

14 See Brunyate's Appendix.

15 Mr. J. Ochterlony outlined this scheme so early as 1840, but for the inevitable delay in the granting of the charter see my book entitled "Organised Banking in the Days of John Company."

16 It must however be acknowledged that during the first few years of its existence loans were made for speculative purposes and a low cash balance was maintained against the total liabilities. See Brunyate, p. 30.

suggested that the levying of these restrictions was solely due to the jealousy of the Government of India which was doing a considerable amount of banking business, specially the management of the exchange business.[17] Some have attributed them to the goodwill of the Government which hoped that these Presidency Banks as semi-official institutions should be conducted on safe and sound lines. Though these restrictions have gone a great way in stabilising these institutions they have hindered the progress of the banks and in spite of continuous and unceasing agitation on the part of the Presidency Banks since the year 1877 they have not been completely reversed. But the ingenuity of the bank's officials combined with the customer's need for money helped the banks to break the actual spirit of the charter though not its very letter.[18]

Another feature common to all the Presidency Banks was their close connexion with the Government. Until 1876 they were semi-sta'e institutions and the assistance of the Government was giving them life and vigour to a great extent. So long as they had the right to issue notes "their paper currency enabled them to adjust the supply of loanable money to demand during the busy and slack seasons." They helped to create and make the people familiar with paper currency. From 1862 they performed the banking business of the Government which entrusted its cash balances in those places where these banks had branches of their own. They were entrusted with the management of the Registered Public Debt receiving a stipulated payment for it. The Government had the right of inspection of the different books and papers of the banks. Their weekly balance sheets were published in the official Gazettes.

The Government never thought it essential to keep these banks under their tutelage but only reserved to itself the right to interfere in case the banks were to go astray. As Keynes explains, "the Govern-

[17] Symes Scutt points out that in 1826 the Bank of Bengal asked the Government of Bengal to extend the privilege of receiving its notes at all Treasuries in the N. W. Province He says sanction was not given as the Government feared that such procedure might damage its exchange operations

[18] See J. M. Keynes' "Indian Currency and Finance," p. 202. He instances how the Presidency Banks virtually loaned money in spite of these rules. From the beginning the regulations as regards loans were "openly contravened,"

ment is bound to come to the rescue of the Presidency Banks in the event of a widespread failure or crisis involving the banks generally so long as it keeps large balances outside the ordinary banking system and so long as it manages the note-issue." It was perhaps also the intention of the Government that all other banks should look upon the Presidency Banks as model institutions worthy of close imitation on their part. The relations between the Government and the Presidency Banks were always amiable and permission was granted in 1898 so that currency chests could be established at any of their branches conducting Government business. A systematic policy of keeping a large part of its balances in the Presidency Banks [19] was pursued and this rendered unnecessary a high bank rate during the period of the late Anglo-German War.

The Government of India never realised that it was extremely unwise to restrict a growing and expanding business by means of antiquated rules. Though the first joint memorial of the three Presidency Banks presented to the Government in 1877, agitated for permission to borrow in London and India and power to deal in foreign exchanges so as to make remittances to England in payment of stock or authorised investments and in repayment of loans borrowed in London, nothing substantial was done when a conference was held in 1899 to discuss these points of grievance. Nothing came out of these representations and the conference in spite of the fact that public opinion condemned the retention of these restrictions. Although foreign exchange business was stabilised by the adoption of the Gold Exchange Standard system yet the Presidency Banks were not allowed to deal with the business on the plea that it would be ungenerous to encroach on the vested interests of the Exchange Banks which have done a great deal of service to this country. A more solid argument was that the Exchange Banks kept their balances with the Presidency Banks and so it was argued that the latter should not be allowed to compete with them with the help of their own money. It was feared that if competition were allowed the exchange banks would retaliate by combining with some big bank of the London Money Market. But after all the real argument that counted was that the Presidency

19 *Vide* Sir William Meyer's Financial statement, 1918-19. See also the Controller of Currency's Report, 1917-18, paragraph 26.

Banks had some business or other to occupy their attention and absorb their working capital. Hence it was recognised that there was not after all much injustice in disallowing them from dealing with foreign exchange business.

Another bone of contention between the Government and the Presidency Banks was the privilege of access to the London Money Market. Although this question was raised in 1877 and although the Government of India favoured this proposal yet the Secretary of State always disallowed this measure. Even so late as in 1914 his arguments for preventing the Presidency Banks from having access to London were supported by many eminent economists in India. The Hon'ble Mr. H. F. Howard remarked that "the absence of such a thing was not a serious defect but it would be a useful thing." The Hon'ble T. Smith of the Allahabad Bank thought it "unnecessary and that Public opinion would be against it." Public opinion was however divided on the question of access to the London Money Market.[20] The late V. D. Thackersey and Chunilal said that "the Presidency Banks were residuary Trustees and hence access should be given to them." The late Sir Bernard Hunter advocated this part of the proposal " but was against giving the Banks the privilege to deal in foreign exchange." Those who objected to the Presidency Banks being granted access to the London Money Market argued that (1) if access were given to them it is not clear it would improve the net aggregate flow of capital into India. To allow all of them to borrow would be " to increase the number of channels through which capital may flow but the volume of it will not increase." But it was not realised that the Exchange Banks did not bring enough capital to suit our needs. Hence their access to the London Money Market ought to have been considered desirable. (2) It would involve the Presidency Banks to deal in foreign exchange while remitting the borrowed money and as it is a fluctuating business no permission to indulge in such unsafe business should be granted. But with the advent of the Gold Exchange Standard System this argument lost its validity altogether. (3) It has been pointed out that " the money brought

[20] Power to borrow in India was granted in 1878 but this remained a dead letter owing to peculiar circumstances of India as Sir Clinton Dawkins stated on 5th January, 1900—Proceedings of the Legislative Council of India.

in by the Exchange Banks—at least a part of it—remains in India in the slack season and is invested in the Rupee loans." This improves the rate which the Government obtains for them. This would not be the case if the Presidency Banks were to obtain the funds. But the real grievance was that enough money was not brought over here. (4) The average rate for councils will be lowered and during the slack season when money has to be sent back it depresses the exchange. It was pointed out that the sale of Council Bills was not to obtain profit but " to meet the present and prospective requirements of the Secretary of State and they must be sold subject to the law of demand and supply." (5) It is quite possible that the banks might not be in a position to pay back the loan for a call for it might be made at any inopportune time. This was after all the only sound argument against excessive dependence on borrrowing in a foreign country. It is this which prohibits the Central Bank of any country from depending on its foreign borrowing powers. (6) It was thought inadvisable that state-subsidised banks should be allowed to compete with the Exchange Banks in financing foreign trade. These have rendered meritorious service in the past and the Presidency Banks should not be given undue authority and advantage over these. Whatever their past services might have been no perpetual monopoly can be tolerated on this score. (7) Finally it was remarked that the three Presidency Banks would competitively pledge Government Securities and would tend to lower their vaule. This argument at least conceded the utility of occasional borrowing to raise funds to meet unusual requirements.

Such were the reasons that were brought forth against the proposal and the plea to borrow in London was always summarily [21] refused even without recognising the real necessity for access to the London Money Market. Evidently the Presidency Banks wished to have access to the London Market so that they might borrow money there and remit it to India during the busy season. The Government balances were indeed a " poor and inadequate substitute for the note-issue." Owing to the traditional aloofness of the Government from the money market

[21] For a discussion of this subject see the papers relating to the proposed establishment of a Central Bank of India, pp. 44-75.

and its Independent Treasury System [22] the evil of shortage of working capital to satisfy the different credit needs was accentuated. As a consequence the banks had to put up their rates at a high figure and the trading community suffered. Thus there was acknowledged rigidity of the credit system during the busy season.[23]

The Presidency Banks proposed that they should be given the privilege to borrow funds in the London Money Market but they did not realise that it could hardly be a real and lasting remedy. Unless a sufficient compensation would exist the Presidency Banks would not after all be tempted to bring over funds from London and unless they were to be employed all through the year at a fairly high rate of interest there would be no profit resulting from their borrowing in Lodon.[24] As such a thing would not be possible in the slack seasons much relief could not have been secured even if the Presidency Banks had been empowered to borrow freely in London. J. M. Keynes repeated the suggestion of granting of

[22] The Independent Treasury System resembles a Central Bank for deposit with branches run by the Government in which the Government is the only depositor and in which there are no borrowers. Many rupees are swept away from the Government coffers just at the time when they would be most helpful in relieving the monetary stringency in the market.

[23] This feature attracted the notice of Dr. N. P. Van Den Berg so early as in 1884 and he quoted the following maximum rates of discount of the Bank of Bengal as an evidence of the inadequacy of credit for internal commercc.

Year.	Bank Rate.	Year.	Bank Rate.
1876	18½%	1880	9½%
1877	14½%	1881	10½%
1878	11½%	1882	12½%
1879	11½%	1883	10½%

See Dr. N. P. Van Den Berg, " The Money Market and Paper Currency of British India, " p. 3. See also the table of figures given by Brunyate in the " Account of the Presidency Banks," p. 104, the fluctuations in the rate of discount up to 1899 are recorded in the table.

[24] It is indeed strange that the argument that a Central Bank should not borrow abroad or lock up its securities as collateral for loans secured has not occurred to anybody. The only explanation that can be given for this is that the science of Central Banking is only of recent growth and as even Central Banks occasionally borrowed abroad at unforeseen times there could only be reference to stray arguments but the theory of Central Bank's borrowing abroad was never scientifically conceived by either the advocates or the opponents of the proposal.

loans from the paper currency.[25] The policy of granting loans was no new thing. As a matter of actual practice loans were given from funds out of the Reserve Treasury. The definite policy on the part of the Government was that "any assistance in relief of the money market which may be afforded by the Treasury Reserve can be made (*a*) through the Presidency Bank, (*b*) at their published rate of discount, (*c*) in relief of temporary stringency." But loans were not freely given during 1893-1899, as it was thought "Money would be re-lent to the Exchange Banks, who may oppose the Secretary of State in the sale of Council Bills."[26] From 1900 loans were given on five occasions. Since 1906, there were no loans granted. The Presidency Banks did not care to borrow money in this manner as the loans were made at the prevailing bank rate and there was no profit for them if they were to re-lend at the same rate. Had there been any margin the banks would have willingly closed with the offer. Recognising these circumstances the Chamberlain Commission advocated the granting of loans to the Presidency Banks at one per cent. below the prevailing bank rate. But the stress of war was felt soon afterwards and these recommendations were not carried out so that no definite arrangements existed to afford temporary relief to the money market through the Presidency Banks.

Some of the other methods proposed were to issue notes uncovered by metallic reserves and the abolition of the Independent Treasury System. But the Government wisely refused to consider the first measure.[27] Till 1920 this archaic, unwise and inefficient method of dealing with the finances of the nation was continued and the Imperial Bank has at last been allowed not only to absorb the treasury reserves

[25] In 1865 the Government granted the Bank of Bombay the privilege to use funds up to Rs. one Crore from the P. Currency Reserve. No actual use was made of this promise. (Brunyate, p. 18.) It was also suggested by the Bank of Bengal in 1898. Refer to Mr. Cruickshank's letter to the Government of India.

[26] See Brunyate, "An Account of the Presidency Banks," p. 18.

[27] See Sir R. Temple, India in 1880, p. 469. An interesting history of the episodes of the Independent Treasury System after 1826 can be obtained in the appendix of the Interim Report of the Chamberlain Commission, Vol. I.—See also Sir Charles Wood's Administration on Indian Affairs, p. 89.

but has also been permitted to have access to the London Money Market. The Government have wisely insisted on the raising of more capital by the Presidency Banks. Lastly they have allowed the expansion of emergency currency during the busy season according to the recommendation of Sir H. B. Smith's Committee. But in spite of these improvements high bank rates still remain as the chief feature of the money market during the busy season. It must be borne in mind that the credit requirements of the country are growing every year and the mere depositing of funds of the Government will not solve the problem. They are too slender to meet the actual requirements of the country. Access to the London Money Market would in pre-war circumstances have been an effective solution. But now that the wastages of war have to be repaired the little capital that will be available will go to the stabilising of the industrial machine whose gear has gone out of order. The London Money Market can ill spare her funds to meet the growing requirements of the Indian capital market. There is very little surplus capital available in London at present for further investment.[28] There is a relative backwardness in the economic position of Great Britain when compared with the United States of America.[29] The usual criteria for measuring the growth of capitalism are the figures of foreign trade, production and income from investments. Owing to disturbed political conditions and the frequency of labour disputes the foreign capitalists would be apprehensive of the future and even though discriminating protection may be adopted yet the flow of capital is bound to be rather weak in the future. There are many other factors hindering

[28] As Prof. T. E. Gregory points out "the London Banks are borrowing short and lending long." It is by this stratagem that the foreign investments of London are increasing. But it is sooner or later to be followed by difficulties. See his address before the Chicago University, June 1928, Economists' Conference on the subject of Foreign Investments of the United States.

[29] Of late there has been some improvement in this direction and London is again coming forward as the world's supplier of long-term as well as short-term capital. See Viscount George Peel.—" The Economic Impact of America," pp. 279 to 298. See also the Statist, October, 1928.

the potential mobility of capital and these lie outside the scope of the banker.[30] So dependence on outside factors should be out of the question. So long as Great Britain aims at the maximum intensity of economic development of the Colonial Empire her first attempts would be diverted to home production and the export of manufactured material so as to create the surplus available for investment. It is hopeless under these circumstances to expect any great relief from this source. The above three methods might act as mere lubricants in the present situation but they are not permanent and radical remedies for the chronic inelasticity of our credit media. The increase of the working capital of the joint-stock banks is the primary remedy and the empowering of the Central Bank with the right to issue notes so as to satisfy the business needs during the busy season is the secondary remedy and these are the only real remedies. A steady supply of loanable capital at moderate rates should be the ideal of the monetary and banking reform of the country.

To solve the problem of seasonal expansion of currency the first thing required is that the banking function should be co-ordinated with the note-issuing function just as one finds it in France. It should be entrusted to the Reserve Bank. The days of decentralised note-issuing have passed away. The Central Bank should issue notes under strict regulations imposed in a carefully outlined charter. Until bank notes and deposits expand in due response to trade requirements, the problem of seasonal expansion of currency without a penalising bank rate will not be successfully solved. The present method of seasonal expansion of 12 crores of rupees on the strength of remedies as laid down by the Paper Currency Amendment Acts of 1923 and 1925 would not suffice. This method is peculiar to our own country. But no important country has set the problem of seasonal expansion of currency in the hands of two different authorities both of whom may be pulling in contrary directions.

[30] Of late Indian industrialists tried to coax foreign capitalists into Indian enterprises but they have preferred to undertake local risks and have only subscribed for a safe proportion of debentures. Even well-established Indian enterprises are finding it increasingly difficult to attract foreign capitalists so easily as before.

The State issuing of notes during 1861-1935 has led undoubtedly to their popularity and wide acceptance and the untutored public might dislike the transfer of the note-issue. They should be taught that the note-issuing function is a part and parcel of the banking function. It ought to be entrusted to the Central Bank which should be responsible to the Government for its sound and successful management so as to secure the wider national interests of the country.

All authors of the numerous proposals of a state-Central Bank unanimously agree on this point. They tacitly recognise that it is only through the agency of the banks that a note circulation can ever attain a thorough development throughout the country. It is through the agency of a bank that a note-issue can be made flexible and responsive to the needs of the community. A Central Bank of Issue has been created and it should be utilised to educate the people in the use of paper currency. It is far preferable to have an increase of paper currency through the hands of a Central Bank rather than an increasing use of token money.[31] As Dr. N. G. Pierson says, " the great increase of token money within our times must be regarded as a retrograde movement in the domain of currency. About the whole of the money should be standard money."

The real remedy for the out-of-date and unbusiness-like rigidity of the credit system is the tapping of more capital from the pockets of the people. The banking habit has to be inculcated. The Indian people should be educated in the economical use of gold and silver they possess. The shortage of real capital can be made good by genuine savings alone. As Ramsay Macdonald says: "Capital that is used for anything except for the specific and economic purposes for which capital ought to be used—for renewing capital, for expanding the effective capital force of the country—is being misused." More of India's raw materials should be converted into finished products and not only should her idle hoards, if they exist be utilised but the hoarding of her talents, her intellects and her economic opportunities and her unlimited resources should be discontinued.

[31] Prof. N. G. Pierson, " Principles of Economics," Vol. I.

The Presidency Bank of Bengal.[32]

(Figures in lakhs of Rupees.)

Year.	*Capital.*	*Reserve.*	*Govt. deposits.*	*Other deposits.*	*Cash.*	*Invest-ments.*	*Dividend, per cent.*
1895		68	185	677	422	132	10
1900	200	103	155	582	243	136	11
1905	200	140	167	1,204	396	181	12
1910	200	175	198	1,609	514	368	14
1915	200	204	265	1,928	285	793	16
1920	200	210	434	3,398	221	910	19½

The Presidency Bank of Bombay.

(Figures in lakhs of Rupees.)

Year.	*Capital*	*Reserve.*	*Govt. deposits.*	*other deposits.*	*Cash.*	*Invest-ments.*	*Dividend per cent.*
1895	100	57	76	358	228	105	11
1900	100	70	87	432	129	89	11
1905	100	87	92	676	259	158	12
1910	100	105	152	1,053	436	149	14
1915	100	100	136	1,079	423	276	15
1920	100	120	349	2,748	876	298	22

The Presidency Bank of Madras.

(Figures in lakhs of Rupees.)

Year.	*Capital.*	*Reserve.*	*Govt. deposits.*	*Other deposits.*	*Cash.*	*Invest-ments.*	*Dividend per cent.*
1895	50	16	45	278	144	45	10
1900	60	22	35	260	82	67	8
1905	60	30	41	344	140	71	10
1910	60	48	72	567	184	85	12
1915	75	65	86	803	256	184	12
1920	75	45	118	1,579	505	211	18

[32] See the Indian Year Book, 1929.

APPENDIX IV.

Table showing the failure of the Indian Joint-Stock Banks.

Year of Bank's liquidation.		No. of Banks liquidated.	Authorised capital (00,000 omitted).	Subscribed capital.	Paid-up capital.
			Rs.	Rs.	
1913 [1]	...	12	274	164	35
1914	...	42	709	245	109
1915	...	11	56	7	4
1916	...	13	230	20	4
1917	...	9	76	35	25
1918	...	7	209	4	1
1919	...	4	52	6	4
1920	...	3	10	7	7
1921	...	7	70	5	1
1922	...	15	1,015	27	3
	Total	123	...	...	193
1923	...	20	2,186	992	465
1924	...	18	630	26	11
1925	...	17	189	25	18
1930	...	12	627	46	40

1 1913 (November and December) saw the commencement of the crisis.

Table showing the Important Banking Failures.

1913.

Year of Regn.	Name of the Bank with its Head Office.	Authorised Capital. (00,000	Subscribed Capital. omitted).	Paid-up Capital.	Deposits.
1901	The People's Bank, Lahore.	35	22	12½	125
1904	The Amritsar Bank, Lahore.	5	5	1½	28
1905	The Lahore Bank, Lahore.	5	4⅘	1	29
1908	The Doaba Bank, Amritsar.	5	3	Rs. 65,845	9
1911	The Indian Exchange Bank, Amritsar.	5	17,310	13,410	2
1898	The Bombay Banking Company.	5	2	1	15
1909	The Credit Bank of India, Bombay.	100	50	10	51
1910	The Kathiawar and Ahmedabad Banking Corporation.	100	75	7	23
	...	... *1914.*			
1906	The Hindusthan Bank (Multan).	10	10	2	10
1906	The Industrial Bank of India (Ludhiana).	5	1	Rs. 54,208	3
1909	(The Public Banking and Assurances Co., Multan).	10	Rs. 17,300	1,964	...
1911	The Bank of Peshawar Multan.	5	4	1	2

1914—contd.

Year of Regn.	Name of the Bank with its Head Office.	Authorised Capital. (00,000	Subscribed Capital. omitted).	Paid-up Capital.	Deposits.
1910	The Popular Bank, Rawalpindi.	50	20	3	18
1911	The Bank of Rajputana (Umbala).	5	2	Rs. 70,501	8
1913	The Solar Bank (Lahore).	100	1	8,500	...
1907	The Oriental Bank of Lahore.	25	10	71,354	...
1904	The Punjab Co-operative Bank, Lahore.	25	10	8	43
1912	The Bank of Asia, Lahore.	25	4	32,099	...
1913	The Union Bank of Commerce, Bombay.	50	...	...	...
1913	The Commercial Bank of India, Gazipore.	10	Rs. 5,775	4,250	...

1915.

Year of Regn.	Name of the Bank with its Head Office.	Authorised Capital.	Subscribed Capital.	Paid-up Capital.	Deposits.
1913	The Amritsar National Banking Corporation.	10	1	1	1
1912	The Standard Bank of Bombay.	20	20	10	...
1912	The Cosmopolitan Bank, Bombay.	20	1	1	...

The first lesson to be learnt from these tables is the startling difference between the authorised, subscribed and paid-up capitals. The low proportion of paid-up capital which is roughly 13% of the authorised capital should be noticed.

The second lesson is that the storm centre was in the Punjab where the Banks that arose out of the industrial and Swadeshi boom of 1906 came to grief.

The third lesson is that the banks have assumed astounding and misleading titles in many cases.

All the tables are taken from the Statistical Tables relating to Banks in India (1930 Edition, p. 35).

APPENDIX V.

General Questionnaire.

1. Where do you get your gold and silver from ? In bullion or sovereign ? Which of the gold bars of the banks are popular and much in demand ?

2. What is the amount of your capital and what is your relationship with the gold and silver bullionists of Bombay ?

3. Do you occasionally place gold bars in the Imperial Bank and secure advances ? If so, at what rate of interest ?

4. To whom do you sell generally gold bars or sovereigns ? In what average quantities ?

5. What is your opinion on the statement that gold is replacing silver in hoards ?

6. To whom do you sell silver ? In what quantities ?

7. In what portion of the year is your business slack and when and how long does your busy season extend ?

8. How many years since have you started this business ? What is your opinion as regards this gold absorption on the part of the people ?

9. Would there be the effective circulation of sovereigns or gold pieces say of Rs. 10 value or any other suitable coin ?

10. Can't the aesthetic tastes of the people be improved by use of diamonds, gems, etc. ?

11. What is your experience of the resale of gold and silver ornaments by owners in times of economic pressure and necessity ?

12. Do the ryots and agriculturists or the middle class and richer professional people generally frequent your shop and can you state in what proportion your business would be transacted with the above classes respectively ?

13. What is the turnover of sale of gold and silver in the busy or the marriage season and to what size would it shrink generally in the off season ?

14. What is the turnover of the sale of locally prepared Lakshmi, Saraswati and other half-sovereigns ?

15. Do you consider it possible to increase the investment habit on the part of the people by increasing their education and pointing out to them the futility of this barren locking up of savings ?

16. How many are there roughly of such retail bullionists of your stamp ? What would be the approximate turnover of the sale of gold and silver by the bullionists ?

17. Do you combine any other business such as money-lending along with your recognised bullion business ? If so, what proportion of capital is locked up in the different forms of business ?

18. Do you undertake to attract deposits and hold them when offered and what rate of interest do you pay ?

19. Does the Bank Rate affect your business and in what way ? Do you draw or discount hundis ?

20. Do you speculate in the value of Government securities and if a stock exchange were to be started in your locality would there be a brisk business in the Government and trustee securities business ?

APPENDIX VI.

THE GOLD BULLION STANDARD.[1]

Introduction.

India is a country in which changes of currency are a great danger, for they make or mar the future of our Indian people. They frighten and exasperate the people and shake their confidence in the new currency proposals that are foisted on the uneducated population unable to adjust themselves to any changes from the normal state of things. The Gold Bullion Standard proposes to inaugurate a most significant change and introduces another experiment in the currency history of the country. The ultimate dethronement of the Silver Rupee and the proposed circulation of inconvertible paper currency [2] would not fail to exercise profound influence on the social habits of the people and on the price of silver. Hence it is imperative to examine the theoretical soundness and its practical utility to the Indian economic system. The recent modification or purification of the conception of the gold standard system must be borne in mind while analysing the gold standard conception.

The Essential Features of Gold Bullion Standard.

It is an *absolute* gold standard without gold currency. Gold is the world's standard and India adopts the same as the standard of value. The local currency is established in relation to gold. The integral and distinguishing feature is that gold coin is not to be in circulation. There is no real conspicuous and visible embodiment of the Gold Bullion Standard in the shape of a gold mint. Gold

[1] This paper was read before the Indian Economic Conference held at Calcutta—January 1927.

[2] Theoretically speaking they are meant for conversion into gold bars alone but this absolute right of convertibility into gold cannot be practically exercised except at limited amounts. Hence it is often referred to as the inconvertible notes.

bullion is to be used for the payment of international indebtedness and it would be freely available for internal purposes. The people possess the rights of convertibility of local currency into gold, the power of melting it and exporting it out of the country.

There is a fixed gold parity of the local currency unit, *i.e.*, the silver rupee or the paper currency note which is 8·47512 grains of fine gold. This is to be the imaginary common standard unit of value and money of account, instead of the present silver rupee which is considered as the standard unit of account by the people.

The currency authority has to buy and sell gold without limit at the fixed par value of the rupee (1*s.* 6*d.*) in quantities of not less than 40 fine ounces. Gold bars are to be given in exchange for local currency, either notes or silver rupees. The sale of gold is so arranged that the currency authority would not become saddled with the task of supplying gold bullion for non-monetary purposes alone. The interests of the Gold Bullion market are thus protected.[3]

The currency authority's sole duty would be to effectively assimilate gold imports and regulate the consequences of gold export. Resolute monetary control and future banking progress are to be the actuating ideals of this institution.

Reasons for taking this step.

As India has been sufficiently educated in the monetary field by the use of token currency and the use of notes and as they have placed greater reliance on notes than coins during the years 1916 19 even though the fiduciary issue has been greatly expanded, the gold bullion standard would be acceptable to the people. It seems to be a rational development of the present monetary system. The rupee would be kept in constant relation to gold at a fixed par value. The ideally best token being paper, this ideal would be best reached under the gold bullion standard. Powers of psychological suggestion and well-directed propaganda would have to be employed so as to secure sufficient general enlightenment in currency matters.

3 But if a higher price is charged for laying down gold in London than the actual cost of transport and loss of interest it would be considered a legitimate grievance on the part of the people. Similarly a far higher price than the actual cost of laying down gold in Bombay and loss of interest should not be insisted upon.

The position of the quasi-standard silver rupee is such that it cannot be declared limited legal tender and brought into disrepute. There are roughly 647 crores of silver rupees minted and although some of them might have been melted the present volume in actual circulation might be estimated at 150 to 250 crores of rupees. Any undertaking of the immediate conversion of these existing silver rupees and the hoarded ones into gold would be unwise, as India would be unable to foot the bill. It would be difficult to suggest any practical limit to the amount of gold required for this purpose. Even if India is unwise to neglect her own interests and be so shortsighted as not to protect the silver hoards of the poorer classes, financiers in other countries have become alarmed at the question of India's return to a pure gold standard and the large absorption of gold that would be required for this purpose. Under the circumstances any co-operation in giving a loan for gold standard purposes would be out of question. Hence to put an end to the present drift policy in currency matters the gold bullion standard has been perfected.[4] So far as India's admission into the financial society of nations is concerned it can be obtained by the gold bullion standard. Effective participation in formulating the world's currency policy can also be secured if the proposal for the starting of a separate Central Bank materialises.

The previous Indian Currency system has assigned no definite place to gold. Without recognising the fact that the value of gold would be changing according to demand and supply for it, the Government of India undertook to fix it down at a constant value to silver coin. Again they undertook to receive gold coin at this rate but not to pay it back to the people. Thus there was no definite policy with regard to the position of gold in the Indian currency system. It was allowed to circulate as legal tender though in fact it ceased to circulate. This anomalous position is now ended and the gold bullion

[4] See Ricardo, "A Proposal for an Economical and Secure Currency." He can be styled the "father of the gold bullion standard scheme." He recommended the use of a paper currency resting not on coin basis but of standard gold bars each weighing 60 ozs. If currency were to be in excess it can be taken to the mint and exchanged for gold bars for exportation If it were deficient gold bars would be brought to the mint and currency demanded. For internal purposes paper would be sufficient as a suitable medium of exchange while for external purposes stamped gold bars could be better suited than coins.

standard has definitley given up gold coin as a form of internal currency.

The Merits of the Scheme.

India can obtain the gold she requires through trade channels. As gold coin in circulation is an obsolescent feature in all civilised countries there would be no frittering away of capital which can be used for the economic development of the country. The economising of gold which is recommended by all theorists and warmly advocated since the days of the Genoa Financial Conference can be carried out effectively under the gold bullion standard. The unlimited acceptance of imported gold at par and unlimited issues of gold for export at par are the cardinal features and a strong reserve of gold would have to be amassed for fulfilling these functions.

There is no immediate degradation or blowing up of the rupee or signing of the death warrant of the rupee. Any immediate demonetising of it would lead to nervousness on the part of the people. Its long history and traditional position are respected. It tends to remain the standard unit of currency till people understand the new standard. Even the silver interests of America or China need not be afraid of an immediate drastic reduction in the price of silver. The Government of India has receded from the silver market so long ago as 1919. The silver producers do not count on the Government of India as an important factor. The sales of silver by the currency authority, which it might deem necessary to sell during the first few years of the working of the gold bullion standard would not happen if rupees go into circulation. The Government and not the new currency authority would remain the purveyor of the silver rupee. The present invisible taxation paid by the country in circulating token currency such as the silver rupee at an increasing value would be rendered unnecessary. The eventual withdrawal of the right of converting notes into silver rupees would force India to depend on the inconvertible paper notes issued by the Central Bank.

The overpowering influence of the India Office in financial and exchange matters would be removed, for the currency authority in

future would be the Central Bank who would be responsible for the soundness and flexibility of the currency system of the country. As banking facilities tend to develop, the discount policy of the Central Bank would enable it to maintain sound monetary conditions. Currency with a stable value is a *sine qua non* for the development of banking. The gold bullion standard secures such stable currency. A wise and proper development of banking facilities can be expected from a successful working of the gold bullion standard. The bank note issued by the Central Bank which is to be the future currency authority, would become an apostle of deposit banking in the country.

The P. C. R. and G. S. R. whose functions were never clearly demarcated in the past get combined and are placed on a statutory basis. The gold in this reserve would prove an adequate support to the exchange and the external value of the local currency unit would be safely maintained under this arrangement. A proper mobilisation of the reserve would tend to facilitate the turnover of the currency. However the right of double convertibility cannot be secured under the gold bullion standard. The new notes cannot be converted into both silver and gold. Such a permanent arrangement cannot be secured even under a pure gold standard. Hence while there is the *de facto* convertibility of notes into silver rupees there is no *de jure* convertibility.

The automatic nature of the gold bullion standard system would be as effective as in the case of a pure gold standard with gold currency. The favourable trade balance would lead to a free flow of gold bullion and as this is bought by the Central Bank, the local currency is released by bank payments made in purchase of gold. The unfavourable trade balance is to be liquidated by the export of gold bullion which has to be purchased by the Indian importers from the currency authority. Gold bullion can be pumped in and out with great ease and facility as the gold import and export points are fixed by statute. This places her on a position of equality with other gold standard countries. So far as internal stability is concerned the ideal of monetary stability can be easily secured through the administrative action of the Central Bank. If the world prices fall a corresponding deflation can easily be managed by the Central Bank's influence on the credit situation. If world prices rise there would be quick adjustment again by the Central Bank's quick action on the internal

currency situation. Now that the gold standard has been restored monetary stability in this country means the adjustments of internal currency to the world level of prices or those of England and the U. S. A. the most important gold standard countries.

The Indian Currency system requires great expansion of internal currency during the busy season for financing the movement of crops and contraction of the same during the slack season. The purchasing of the unlimited stocks of silver or the tinkering of the P. C. Reserve would be rendered unnecessary by the currency authority. As bills of exchange would become popularised and drawn for the payment of the crops, these would be discounted in the money market and the banks requiring further resources would rediscount these bills at the hands of the Central Bank which can issue notes on these commercial bills. The bank can buy gold bullion from the people and this would expand the volume of the local currency. The centralising of the currency and banking reserves in the hands of the Central Bank would reduce the fluctuations in money rates and the hitherto divergent policies in regard to currency by the currency authority and banking by the banking authority would be given up. Internal prices would be placed on a more stable basis than under the Gold Exchange Standard System.[5] The proper regulation of the discount policy by the Central Bank would make the currency expansion and contraction automatic. The statutory constitution of the combined reserve to be placed in the hands of the Central Bank allows it to expand and contract currency according to seasonal demands. So far as automatic contraction is concerned it can be brought about as soon as people feel that local currency has depreciated in terms of gold and they would hasten to the bank to convert the local currency into gold bullion which the bank has to sell.

The Gold Bullion Standard does not debar the country from the possibility of the ultimate resumption of gold currency. Thus the gold currency standard can be reached if sufficient gold reserves are accumulated, but the education of the people in the use of the new

[5] There should be no misapprehension under this heading, Absolute guarantee against fluctuations in purchasing power is not afforded by the G. B. Standard system. Nor can it be attained by any other system which has been so far outlined by the monetary reformers.

inconvertible rupee note and the other denominations of paper currency popularised by the bank would be such as to open the eyes of the people to realise the uneconomical character of gold currency. For the time being there would be no free internal circulation of gold but it is quite likely that if banking education proceeds apace we would never be desirous of it. The introduction of the one-rupee note would go a long way in this direction. It would soon become the principal constituent of internal currency.

The institution of the " On Tap Savings Certificates " redeemable at the end of three or five years in legal tender money or gold bullion with an attractive rate of interest attached to them is a moderate attempt to counteract the unproductive employment of the yellow metal. Though they are poor substitutes of gold notes which carry the right of convertibility into gold coins, they can do much to encourage the investment habit on the part of the people who can afford to save.

The demonetisation of the gold sovereign is also a feature which should not escape one's attention. The sovereign has been both a " benefactor and the nightmare " of the Indian currency system. The obvious advantage is the possibility to introduce a new gold coin and gold mint in our country when gold coin is considered necessary and the position of the reserves is such as to facilitate it. The present demonetisation of the sovereign would be no real danger as India's main demand for it is only a bullion demand and not a coin demand. The bulk of the Indian people find the rupee a more suitable coin than the sovereign. The gold sovereign is not a real Indian coin. Besides this reason we have the following most important reason for demonetising the sovereign which is not usually taken into consideration. For a supply of this coin India has to depend on England. The currency authority in India cannot control the issue of this coin and such a coin should find no place in the Indian currency system. A sound currency system is that which gives scope to the currency authority to control and regulate every important coin which is a constituent feature of the system.

Supposed demerits of the scheme.

The working of the system in all its details will take some time to begin. There should be the formation of the Central Bank and

the accumulation of the necessary gold reserves in India. A large number of rupees would be presented to the Central Bank for conversion into gold bullion. There is already a fall in the price of silver and its future fall would stimulate the demand for gold and it would be unwise for the Central Bank to begin operations with a slender stock of gold. In other respects it can begin straight away. Some of the measures that can be taken up immediately for increasing the gold stock of the Central Bank should be considered. The import duties can be made payable in gold or gold equivalent. The Indian export bills are to be taken up in sufficiently large number and gold can be secured from their proceeds. An attempt to retain the gold produce of the country should be made.

The first essential of a currency system is that it can be understood by the people and that it should be of such a nature as to be acceptable to them. The popular sentiment is in favour of a gold standard with gold in circulation. When this is denied it would be considered, rightly or mistakenly, that it is less automatic and less free from manipulation than the pure gold standard with gold currency in circulation.

The position of the silver rupee would be looked upon with certain misgivings as the people would not obtain them as a matter of right from the Central Bank in return for its new notes. The new Reserve Bank note and the silver rupee would both be legal tender currency in the gold bullion standard system. Holders of notes can secure rupees only at the will of the Reserve Bank. The paper note is neither convertible into the silver note, as at present, or into a gold coin but both those are convertible into gold bullion—the standard of value. The exchangeable limit of the local currency into gold bullion is too high.[6] It is only the bullionists and the rich men that can afford to do it. The present note-issue is convertible into silver rupees. The issue of a new inconvertible note would tend to make the people cherish the present note and the new inconvertible note would perhaps be at a discount. It might be a note payable in gold but the legal line of difference drawn between the old and the new double-guaranteed bank note is to be deprecated.

Even the 1927 Gold Standard Act has not done sufficient justice in this respect.

There is no statutory undertaking that the free inflow and outflow of gold would be permitted without any direct or indirect limitations, on the amount of gold coming in or going out. The location of the gold securities in London would not be liked by the people. As the Central Banker's gold reserves might again be depleted too readily when the people require commodity-gold attempts have been made to protect the bank against such a drain. Similarly the free inflow of gold must be ensured.

Although we have at present an excellent opportunity to settle the national currency question, the Currency Commission by prescribing the Gold bullion system has not succeeded in this task. The gold bullion standard can at best be accepted by the people as a half-way house leading to the adoption of the pure gold standard with gold currency in circulation in the near future. Academically speaking the gold bullion standard is a step nearer to the international exchange standard recommended by the G. I. Financial Conference and is really an improvement on the gold standard with gold currency in circulation.

Comparison with Gold Exchange Standard.

It has undoubtedly the following points of superiority above the defective Gold Exchange Standard system, *viz.*, the giving of gold bullion in return for local currency for all purposes, the statutory basis of the combined reserve, the banking management of the currency and credit policy and the economy of gold. It is doubtless inferior to the effective gold standard plan, at least from the standpoint of public sentiment and confidence. It is the fond hope of the economists that a gold currency would make it possible for India to mobilise the liquid resources and increase the turnover of currency But the main point of increasing the capital resources cannot be solved by merely multiplying currency. Greater means for mobilising capital resources are the real remedy. It would require an extensive educational campaign to make the people realise the true implications of the gold bullion standard. Otherwise appeals to economic arguments will become vain in face of the existing and overwhelming liking for the gold standard with gold currency in circulation.

No Danger to Trade.

It is openly stated that trade with Africa and the countries on the Persian Gulf would be hindered as the present financing medium is the silver rupee. The gradual dethronement of the rupee would however give full time for adjustment and no serious danger need be felt.

The view is too often held that India is a sink of precious metals. Although this is quite a superficial view it must be admitted that an unwise use of existing stocks of gold is being made by the uneducated people. This is likely to continue under any system. Increased education, improved legal and economic status for women, the raising of the standard of living and the development of banking facilities are the necessary correctives. But as the existence of this habit would have an adverse effect on the gold reserves of the Reserve Bank, every attempt must be made to change the ways and habits of the people with reference to the accumulation of the precious metals. Monetary Reform and banking reorganisation must be considered as mutually convertible terms, the one cannot succeed without the other. Both must go hand in hand.

Should we accept the Gold Bullion Standard ?

Although several economists and witnesses before the Hilton-Young Commission have pointed out that India has to pass through the necessary stage of gold currency in circulation before it could hope to attain the ideal currency system this advice has been disregarded. The gold standard as understood in the modern sense is really granted and the means to secure gold currency in future are carefully preserved so that "optional gold currency" can be grafted on the currency system. The preliminary stage is accomplished and although the Commission do not think it advisable to vote for the gold currency ideal, it can be secured through the will of the Legislature as soon as the gold in the reserve permits it.

The scheme can be accepted if the Legislature can introduce the proviso that after the lapse of a certain period the right of coining

gold bars into coins or mohurs could be granted to the people if they so desire it. The composition of the gold in the reserve should be placed at a high ratio of the total amount. As soon as this higher portion of gold is reached, the right of giving gold to the holders of silver and coins can be undertaken. Thus at last can we rid ourselves of silver and "slough off the remains of the old skin." The rapid attainment of the final stage would depend on increased education, the raising of the standard of life, and the perfection of the banking system, and when these are secured the uneconomical nature of the gold currency would be realised. The gold bullion standard would remain *in toto* without the unnecessary excrescence of gold currency attached to it. There would be no need to feel any regret at the conclusion. The currency question has been racking India for the past several years. It will continue to do so for a longer time under the Gold Exchange Standard system. Until we are prepared to accept and use the new currency bridge, *i.e.*, the gold bullion standard, the attainment of the ideally best currency which is the ultimate goal would be postponed *ad infinitum*. Academically viewed the Gold Bullion Standard is infinitely superior to the present policy of drift in currency matters. Practically speaking it is the only successful monetary reform that *unaided India* with its *meagre resources* of gold can achieve with maximum profit and minimum disturbance to our country as well as others. Sentimentally viewed it fails to take cognisance of the overwhelming liking of the Indian people for gold currency in circulation. Psychologically considered it is a bitter disappointment to popular expectations.

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OPINIONS ON THE THIRD EDITION OF

" PRESENT-DAY BANKING IN INDIA "

1. **Present-Day Banking in India, by Dr. B. Ramachandra Rau, M.A., L T., Ph.D., F.R.E.S. (Lond.), Third Edition (Thoroughly Revised and Enlarged)—supplementary thesis for the Degree of Doctor of Philosophy, Calcutta University. Royal 8vo pp 704. 1930. Price Rs. 10.**

The book describes the existing banking system and offers valuable suggestions to bring about the much-needed improvement in our credit situation. The present edition besides embodying the main conclusion of the earlier edition incorporates a large amount of fresh material.

" A complete survey of the position—further useful chapters have been included on the recent monetary reform and the Central Bank of Issue. He examines the position of each of the constituents of the Indian banking world and suggests scientific remedies. His work will be much appreciated by his readers among the English banking community who will be specially interested in the author's suggestions as to the course which should be taken in the future."—*The London Bankers' Magazine*, Nov. 1930, p. 773.

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of his own of the question of a Central Bank of Issue for India. His treatment is sound and his sweep wide, considering the fact that he wrote before the publication of the Banking Committee's exhaustive and weighty report."—*The Ceylon Economic Journal*, Dec., 1931.

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5. **Banks and Money Market, by Dr. B. Ramachandra Rau, M.A., Ph.D., F.R.E.S. (Lond.) Pp. 258. Rs. 2.**

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